

An Overview of Recent Economic Trends & Utah's State and Local Tax System

Prepared for:

Utah Legislature
Revenue and Taxation Interim Committee

June 23, 2010

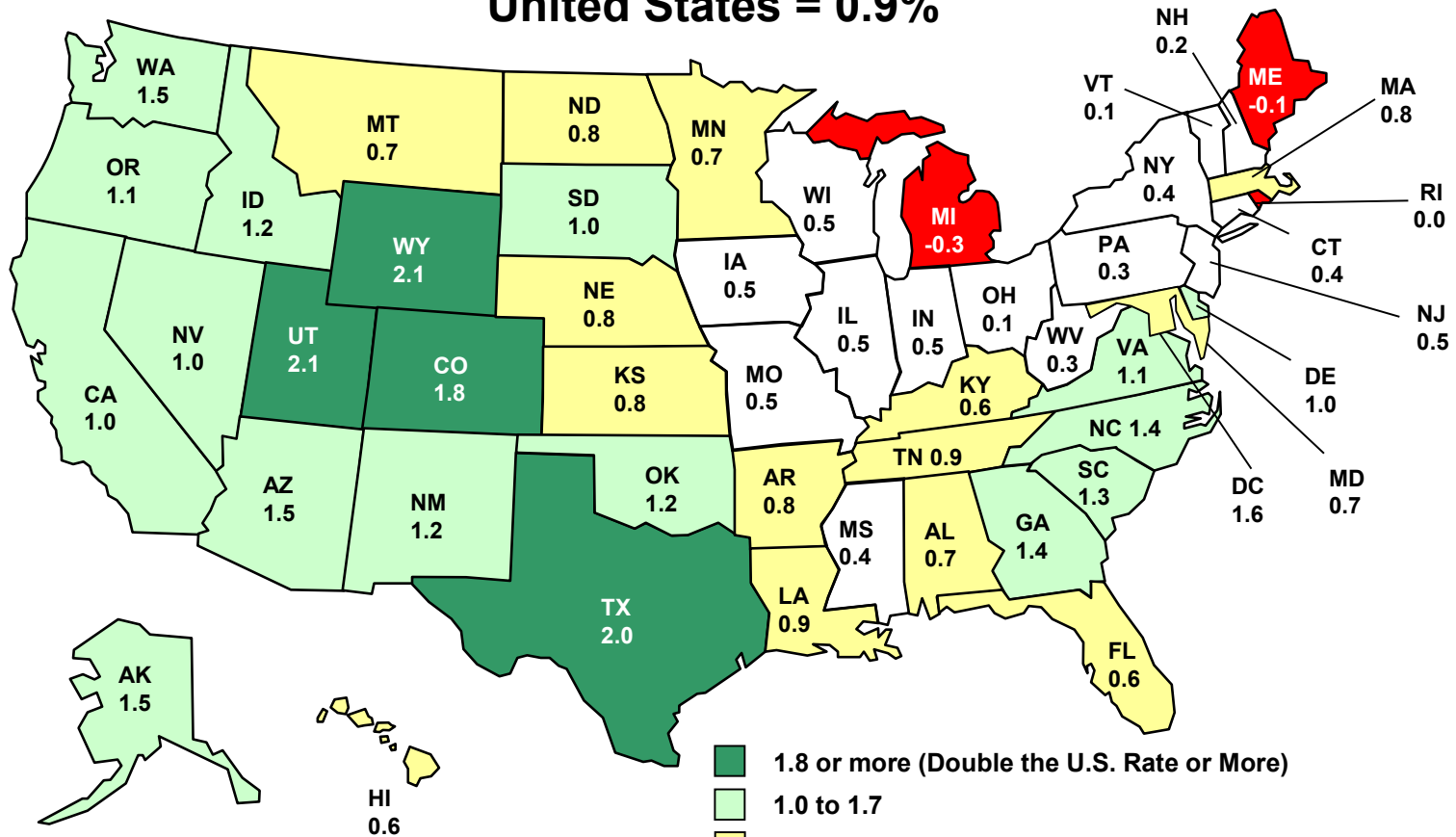
Presentation Outline

- Economic indicators
 - Population
 - Employment
 - Housing & Construction
- State and Local Tax System
 - Income tax
 - Sales tax
 - Property tax
 - Fuel taxes
 - Interstate comparisons

Utah

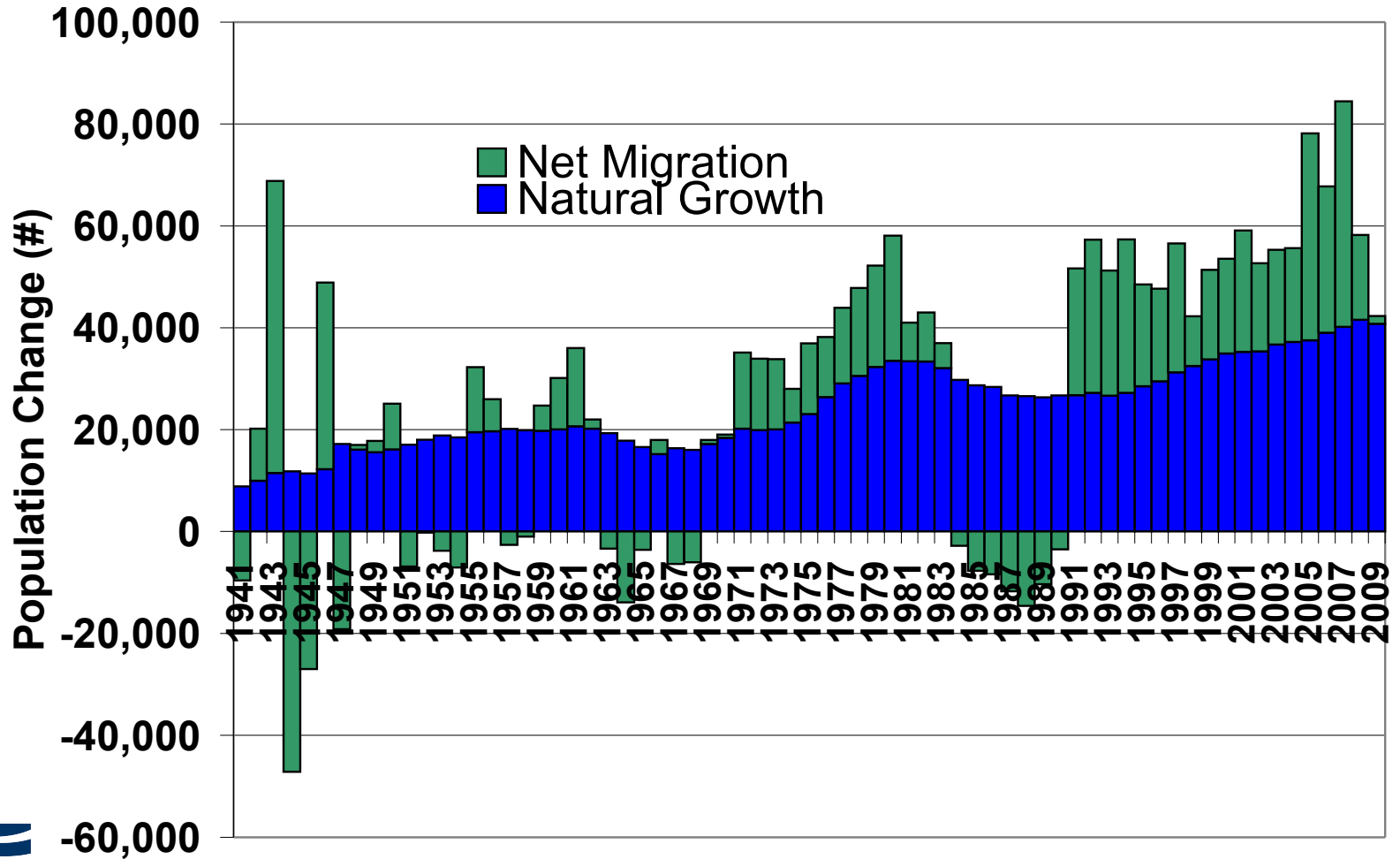
The Second Fastest Growing State in 2009

Percent Change in Population for States: 2008 to 2009
United States = 0.9%



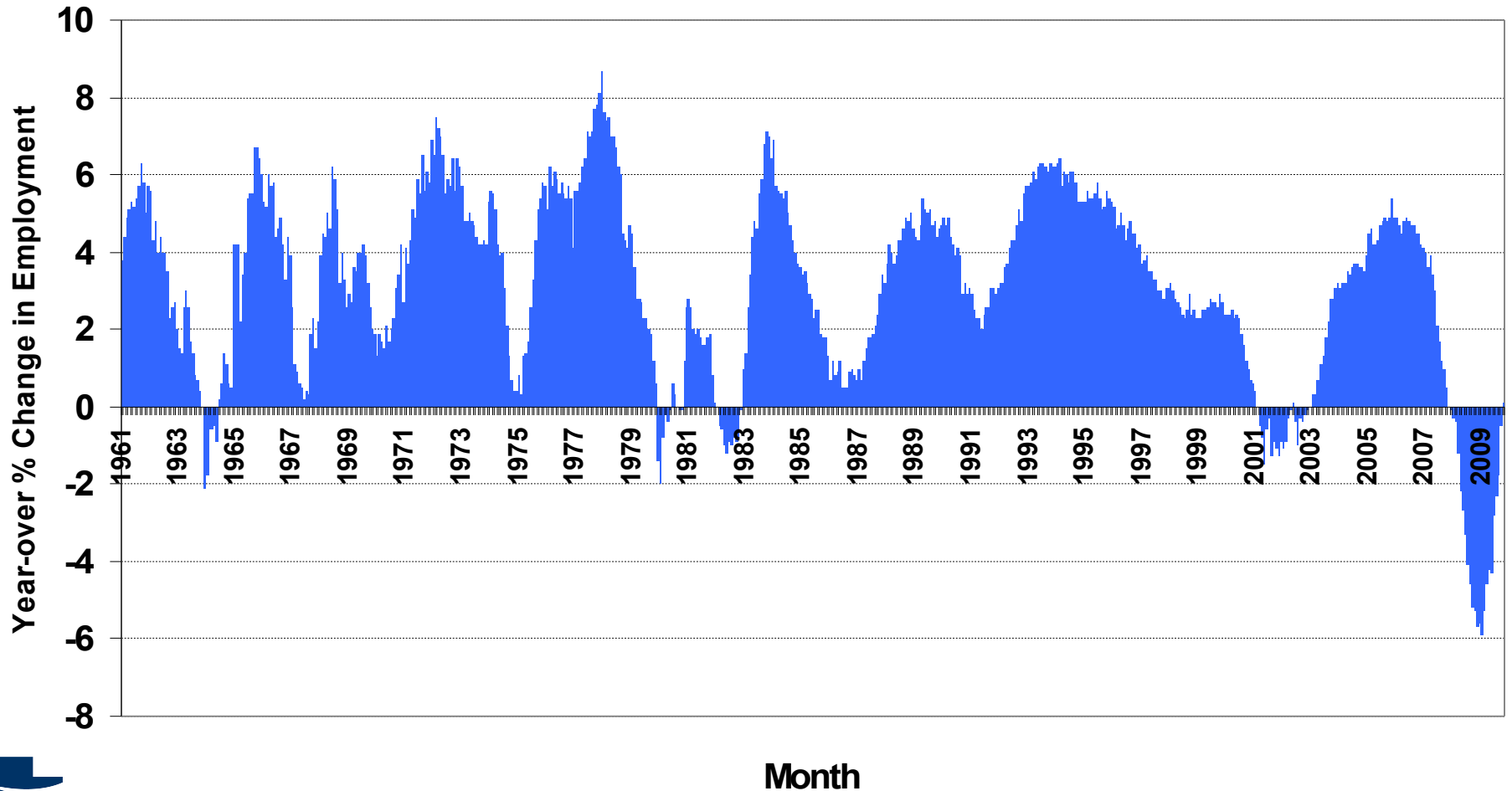
Components of Utah Population Change

1941 to 2009



Utah Employment Growth Rate

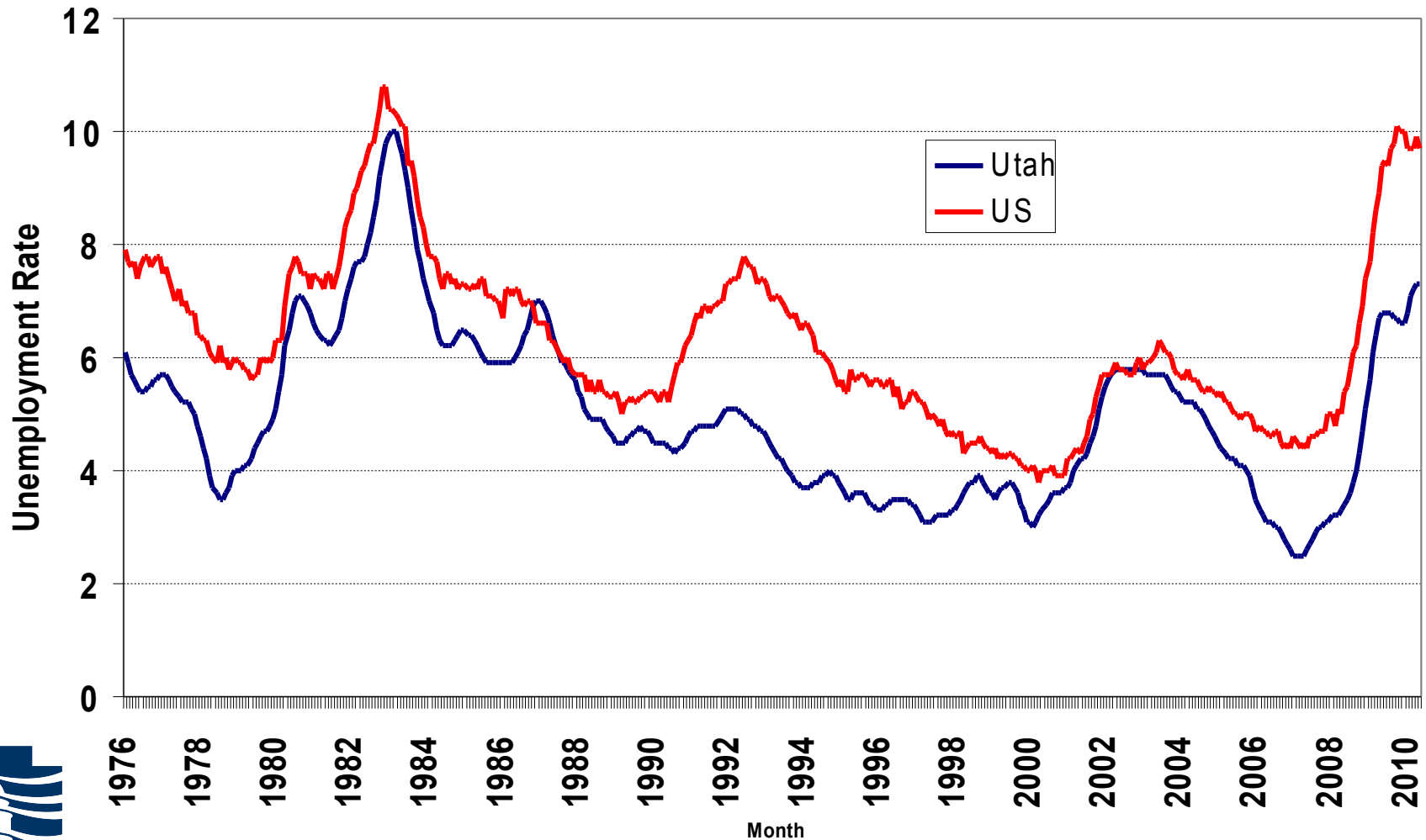
January 1961 to May 2010



Unemployment Rate

Utah and the US

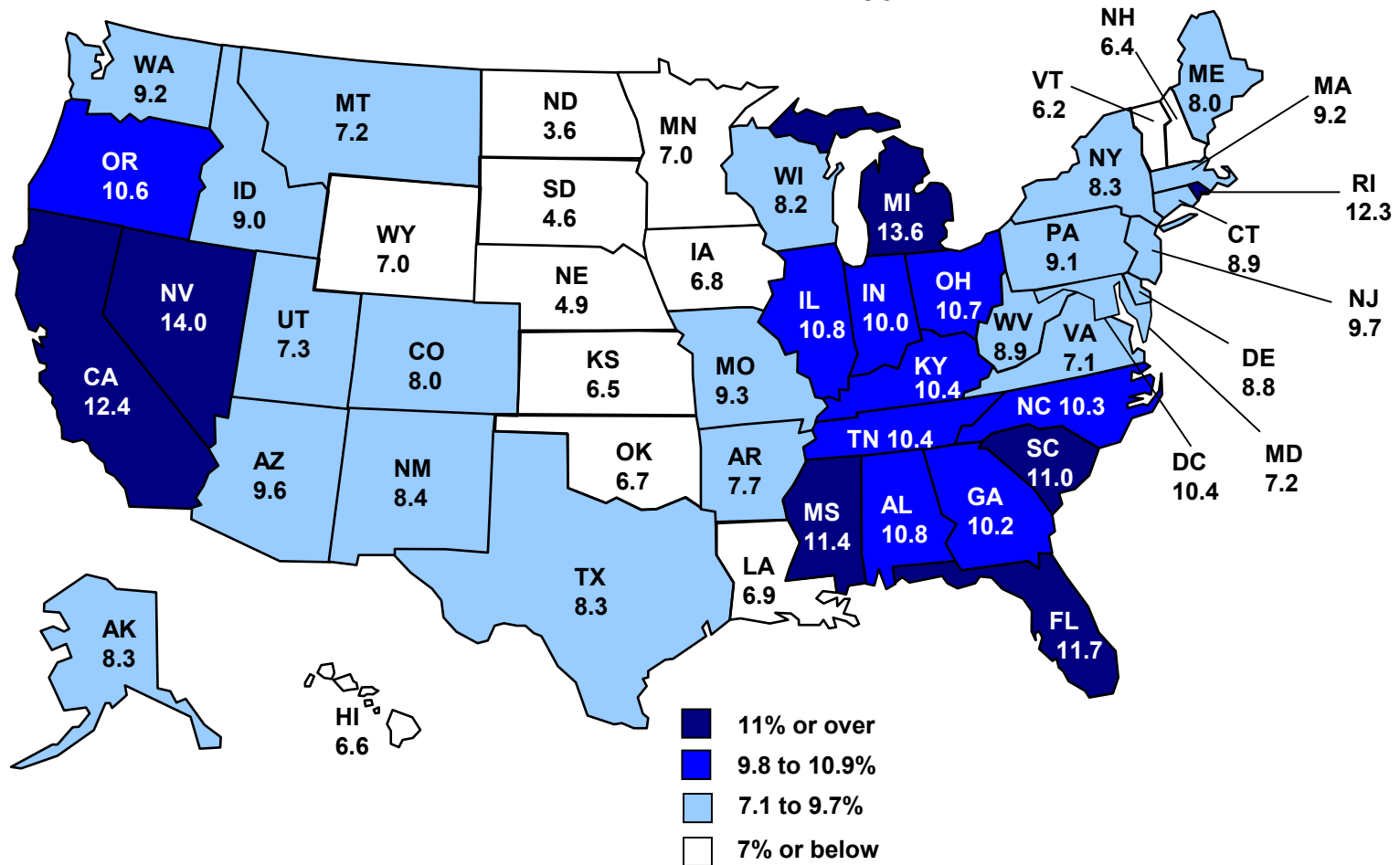
January 1976 to May 2010



State Unemployment Rates

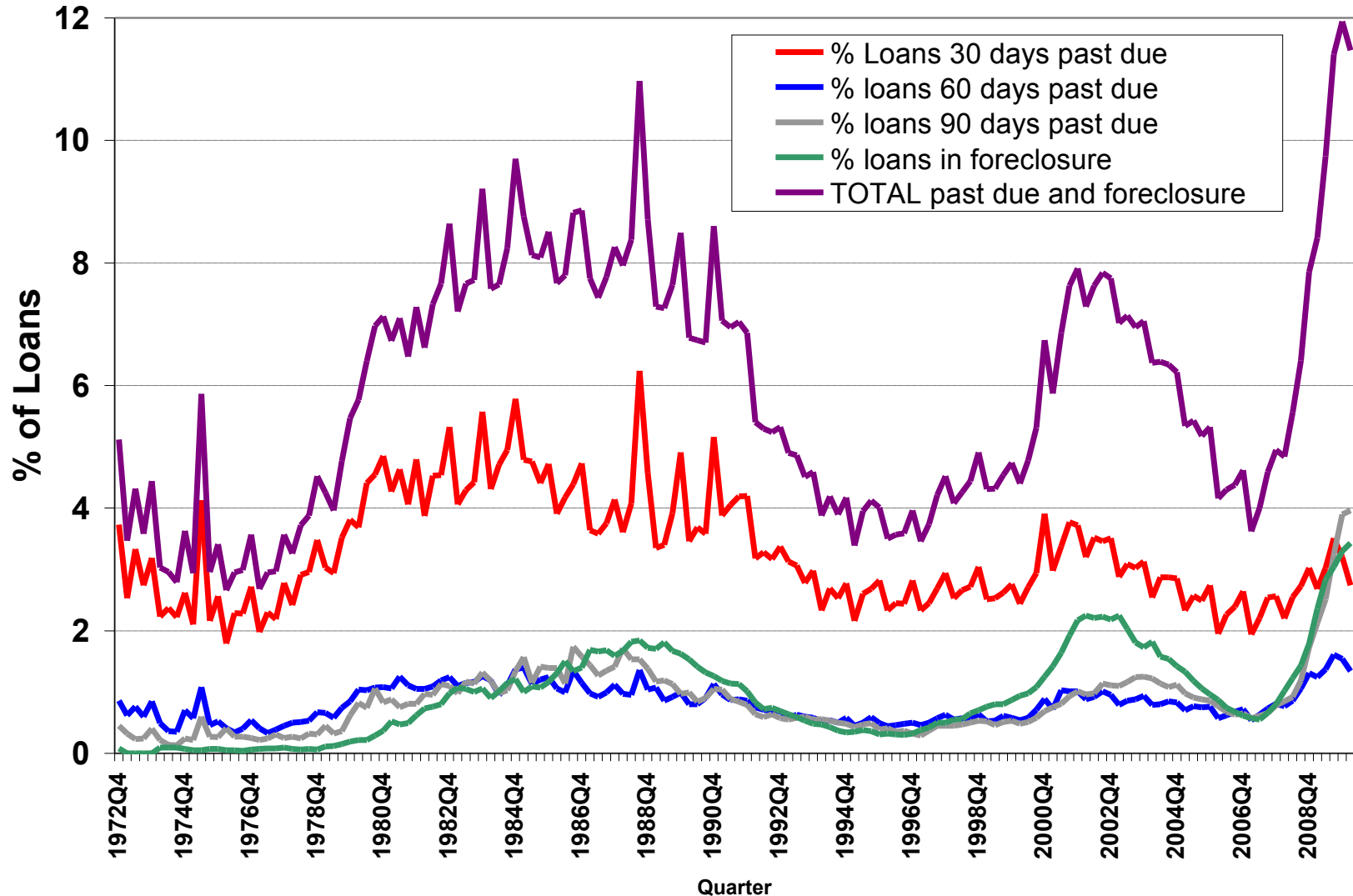
May 2010

United States = 9.7%



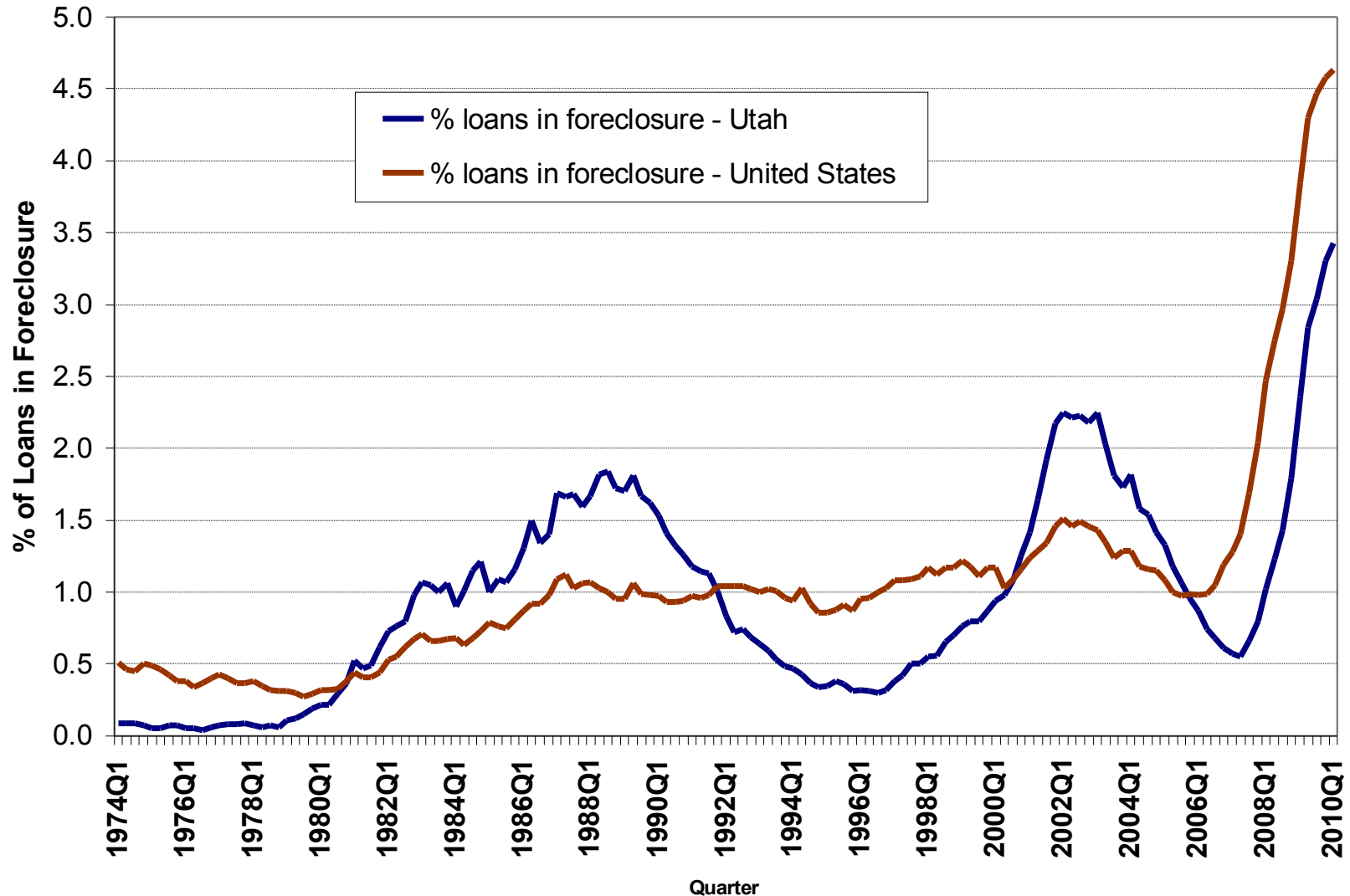
Utah Housing Markets

Delinquencies & Foreclosures, 1972Q4 to 2010Q1



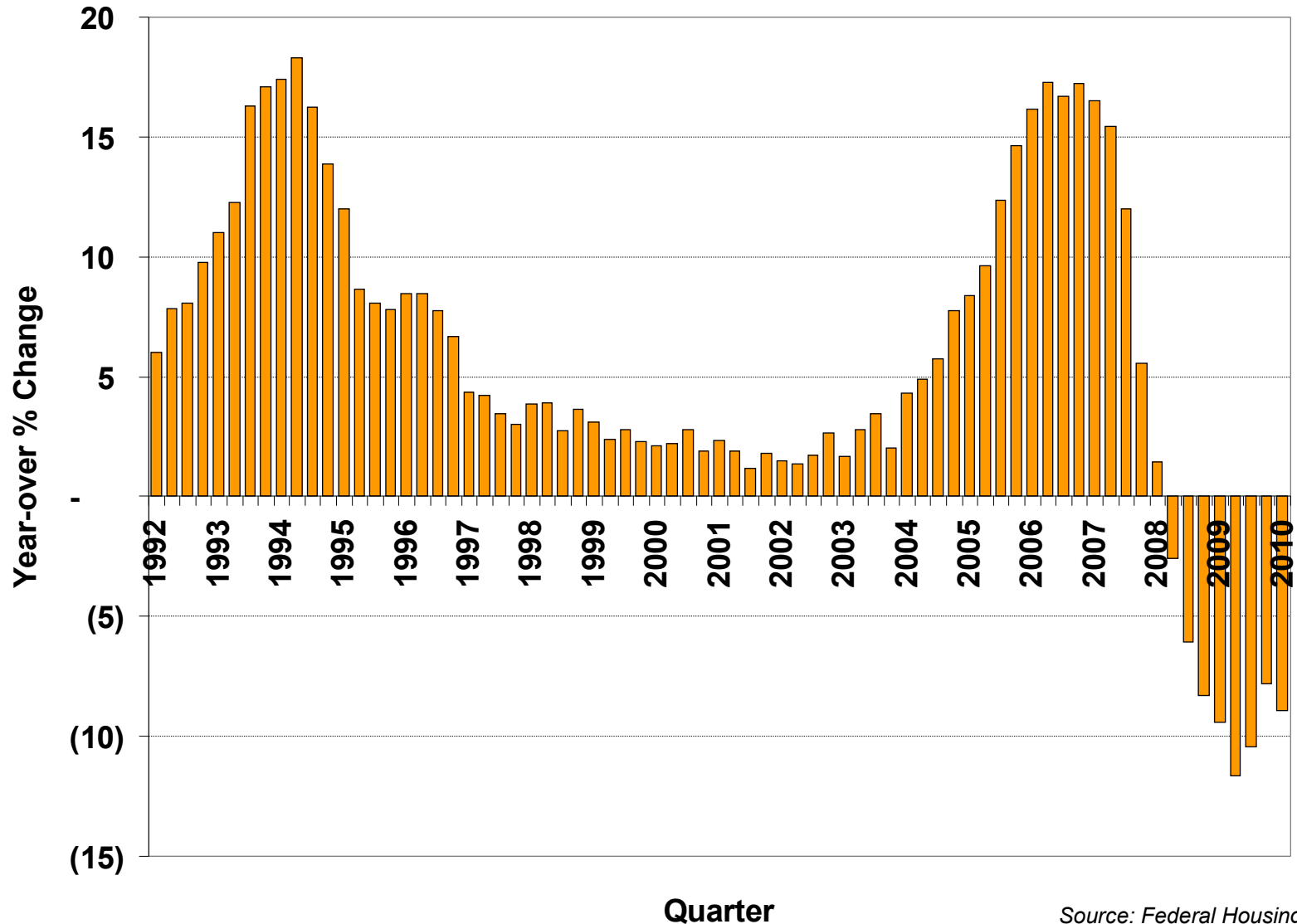
Utah Housing Markets

Foreclosures, 1974Q1 to 2010Q1



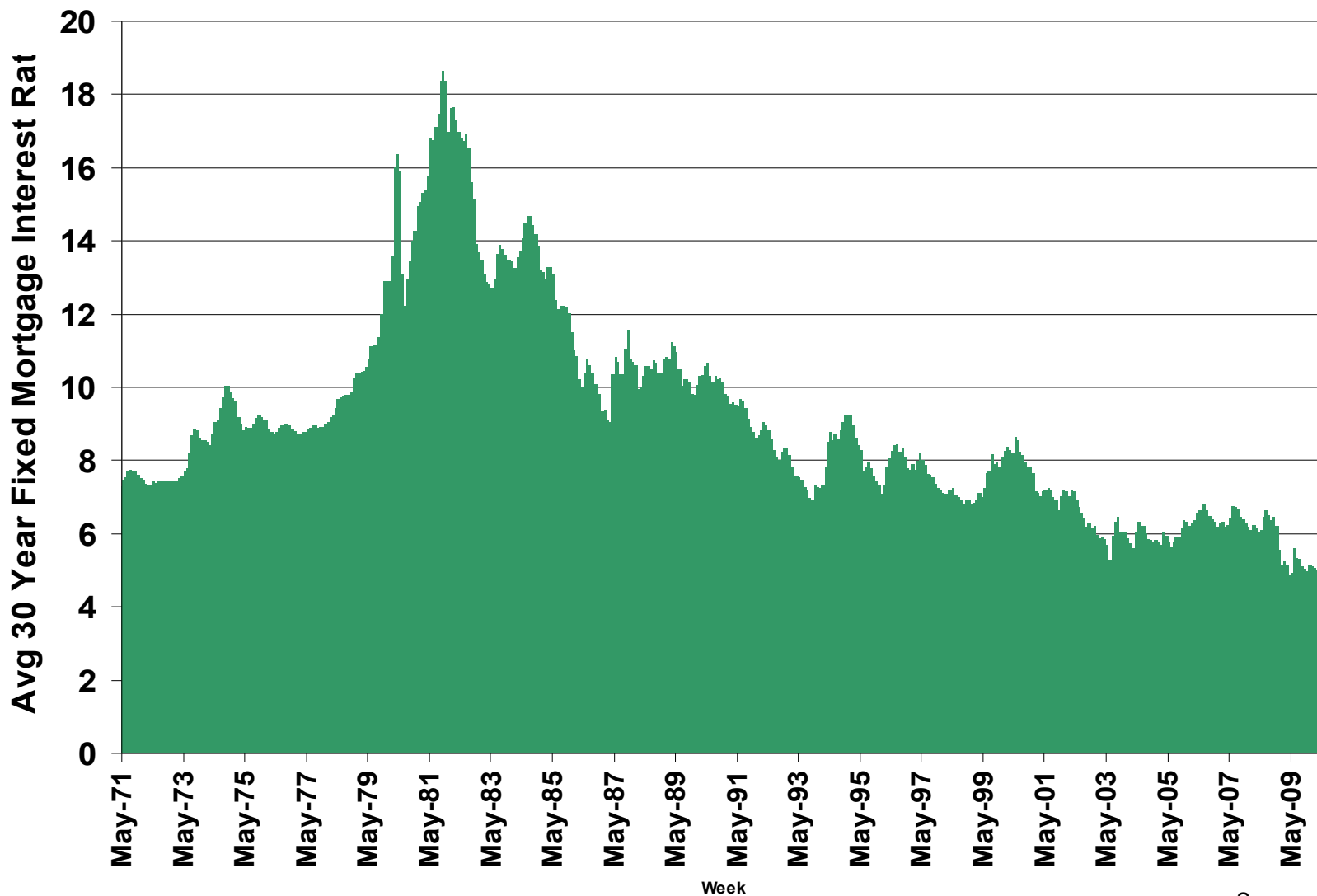
Utah Housing Markets

FHFA Index Percent Change in Home Values 1992Q1 to 2010Q1



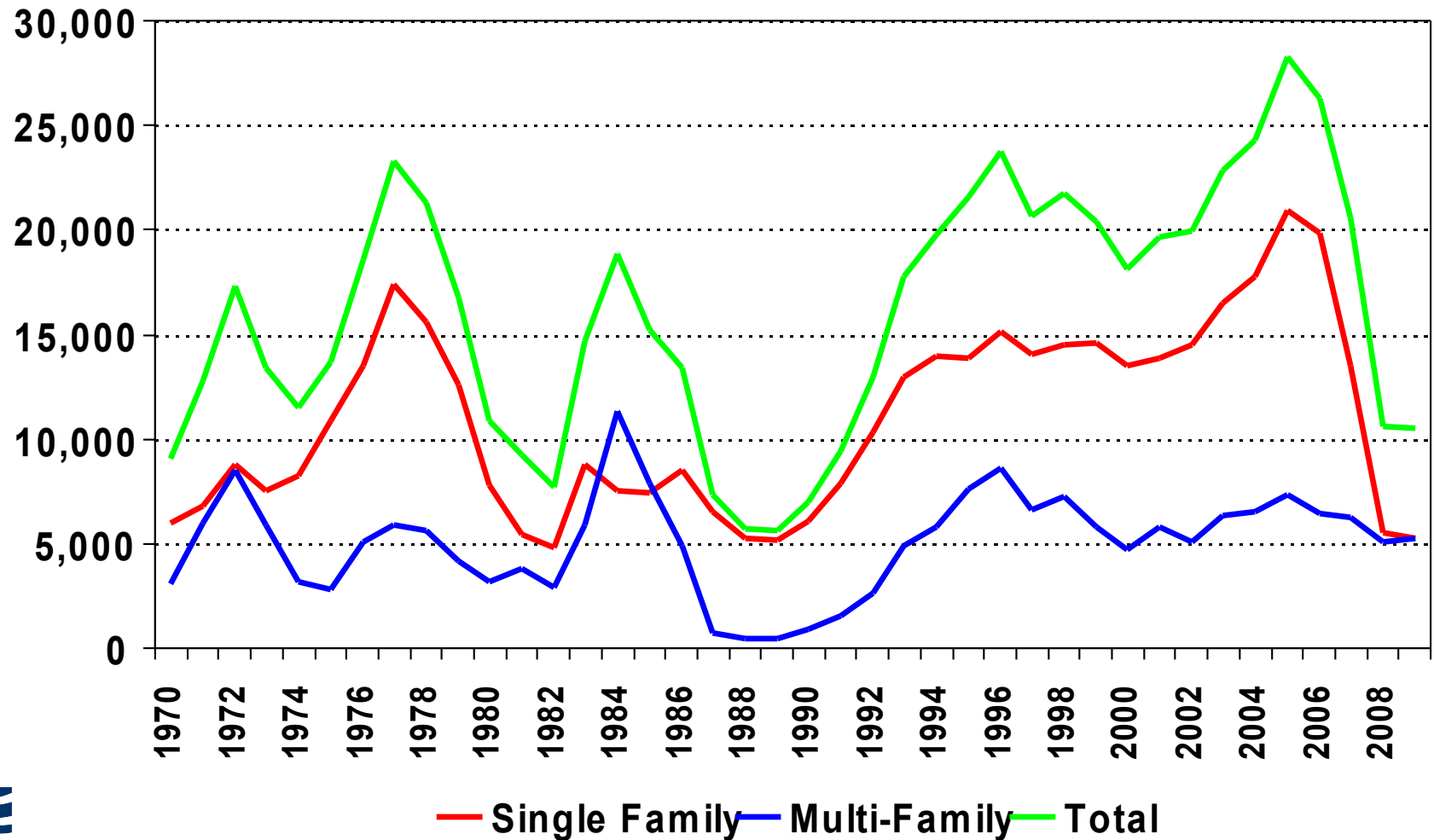
Housing Markets

30-year Fixed Mortgage Interest Rates May 1971 to June 2010



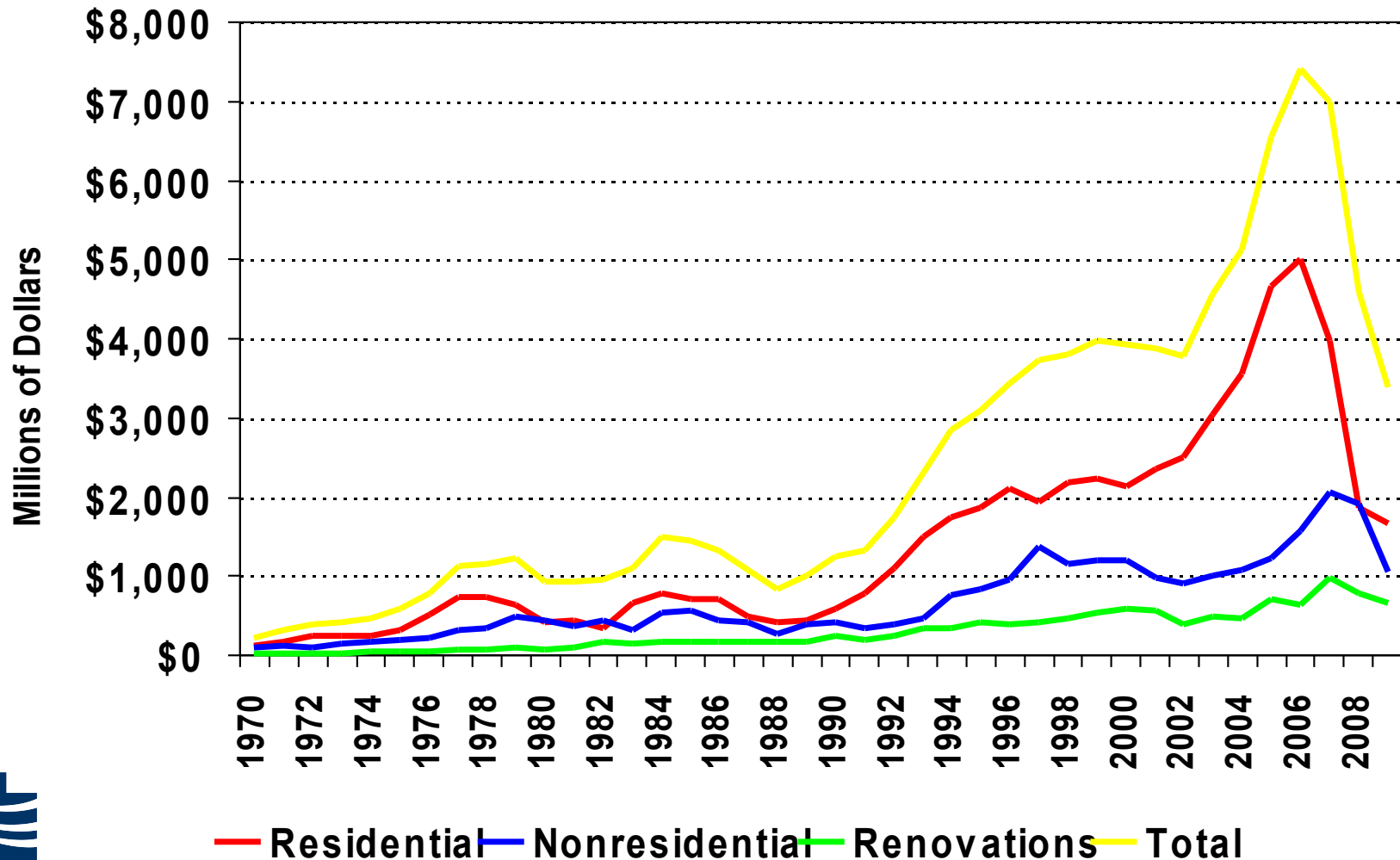
Number of Permit Authorized Residential Units

Single and Multi-Family: 1970 to 2009



Permit Value of New Construction

1970 to 2009



Presentation Outline

- Economic indicators
 - Population
 - Employment
 - Housing & Construction
- **State and Local Tax System**
 - Tax policy in general
 - Income tax
 - Sales tax
 - Property tax
 - Fuel taxes
 - Interstate comparisons

Why Does Tax Policy Matter?

- Sound tax policy is concerned with how taxes:
 - Are designed and administered
 - Affect the taxpayer
 - Affect the economy
- Independent of the amount of money taxes raise
 - Should consider if goal is to cut taxes or increase taxes
- Affects every citizen of Utah
- Provides revenue for state and local public services

Elements of an Optimum Tax System

- Reliable
 - Sufficient
 - Stable
 - Certain
- Equitable
 - Vertical Equity
 - Horizontal Equity
- Simple
 - For taxpayers to pay
 - For tax collectors to collect
- Responsive to interstate and international competition
- Economically neutral
- Accountable and transparent

Utah's Three Major State and Local Taxes:

Individual Income, Property, and State and Local Sales and Use

FY 2009

Property Tax

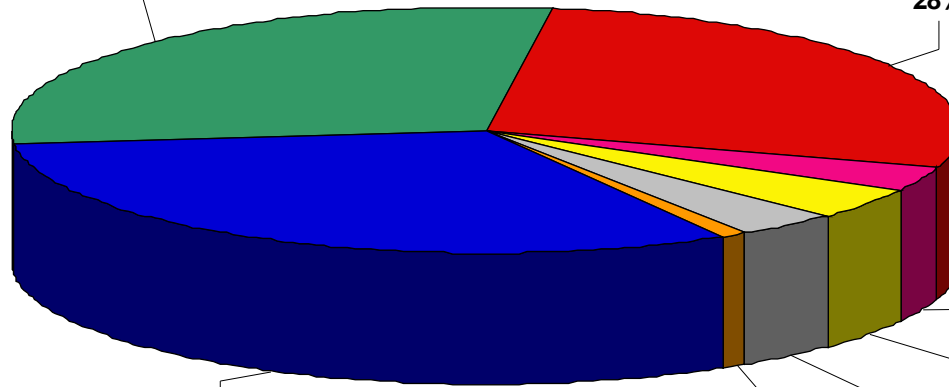
(local)
\$2.4B
29%

Individual Income Tax

(state)
\$2.3B
28%

Sales Tax

(state & local,
including earmarks)
\$2.6 B
31%



Corporate Income Tax (state), \$0.25B,
3%

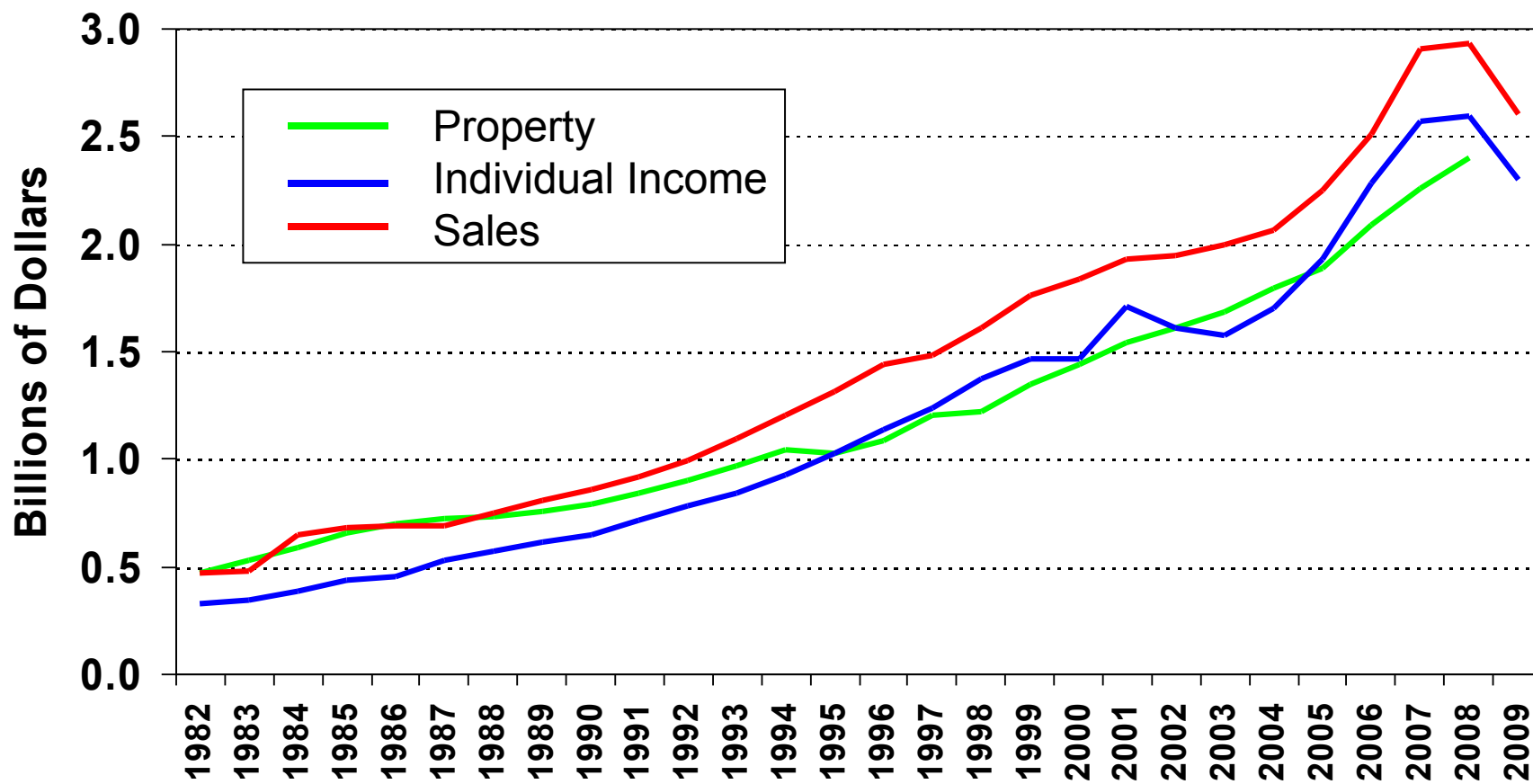
Transportation Taxes (state), \$0.34B,
4%

Other State (severance, cigarette,
insurance, etc.), \$0.30B, 4%

Other Local (Excise), \$0.07B, 1%

State & Local Sales and Use, Individual Income, and Property Tax Revenues

FY 1982 to FY 2009



Utah's Individual Income Tax System

Utah's Single Rate

Individual Income Tax

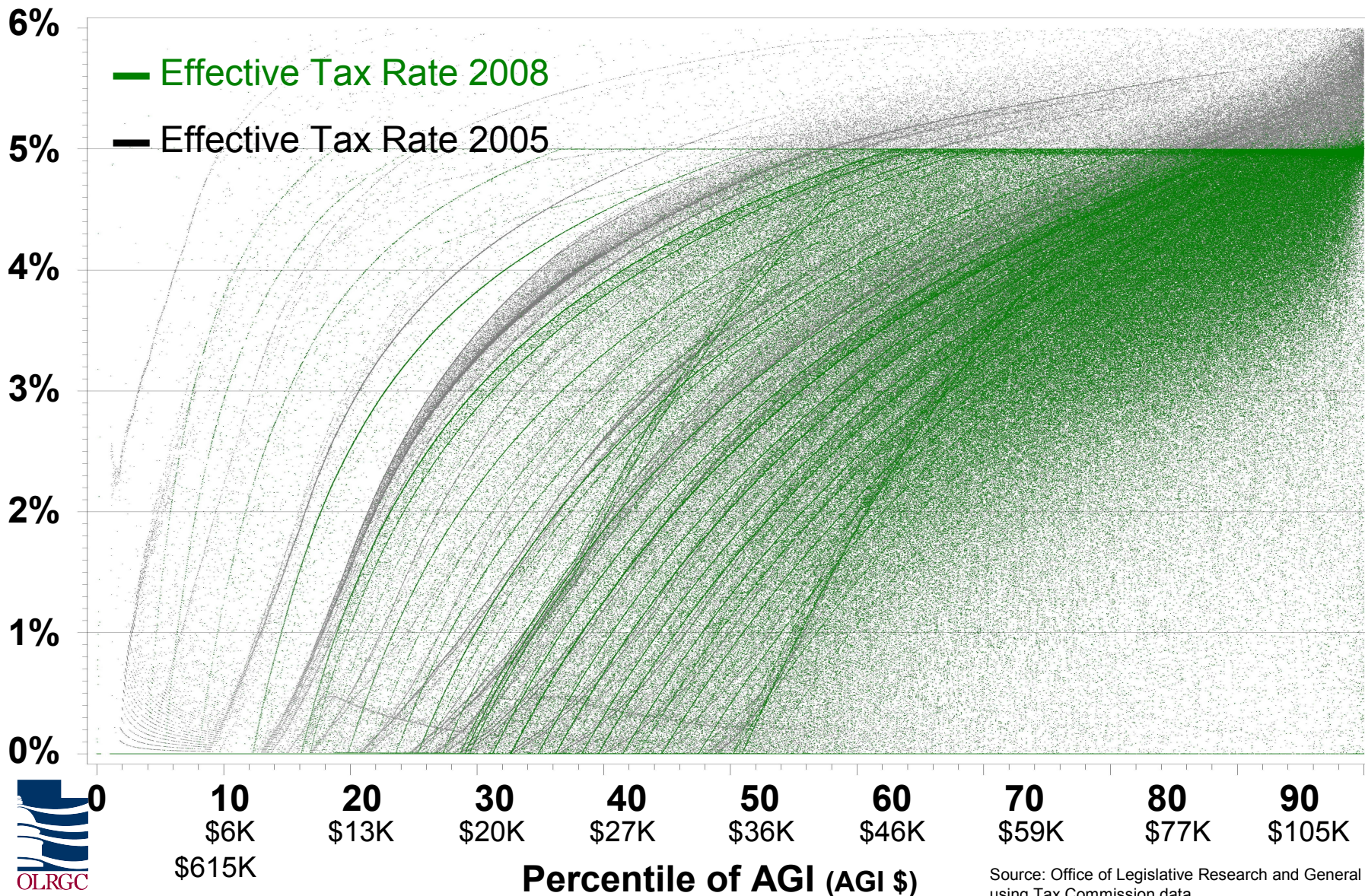
- Took effect tax year 2008
- 5% of state taxable income
 - Start at federal adjusted gross income (AGI) with certain additions and subtractions
- Taxpayer Credit:
 - Equal to 6% of:
 - Federal standard deduction or itemized deductions other than state income taxes, and
 - 75% of federal personal exemption
 - Credit phases out by 1.3 cents for each \$1 above
 - \$24,000 married filing jointly
 - \$18,000 head of household
 - \$12,000 single
 - Phaseout beginning points indexed for inflation
- Retirement Credit (taxpayers born before 1953)
 - \$450 for 65 and older
 - \$288 under 65 with certain retirement income
 - Credit phases out by 2.5 cents for each \$1 above
 - \$32,000 married filing jointly and head of household
 - \$25,000 single

Effect of Income Tax Changes

- Despite “flat tax” moniker, overall the new system is progressive with respect to AGI
 - Basic Tax Formula (**Tax base x tax rate[s]**) – **tax credit = tax liability**
 - Old system – progressive through **tax base** and **tax rates**
 - New system – progressive through **tax credits**
- Briefing paper available summarizing major tax changes and impacts
 - <http://www.le.utah.gov/lrgc/incometaxchanges.htm>
 - <http://www.le.utah.gov/lrgc/briefingpapers/IncomeTaxJan2010.pdf>
- Withholding changes alter the timing of income tax collections
 - This could mean that taxpayers whose tax actually goes down may perceive a tax increase because they either send in a check with their return or receive less of a tax refund

Income Tax Effective Rate Chart

Actual Tax Year 2008 Returns, by Percentile of Income



Why Does the Individual Income Tax Matter?

- Constitutionally earmarked revenue for public education and higher education
- Greatest ability to adjust for ability to pay and offset regressivity of other taxes
- Most detailed information on taxpayers
- Visible
 - \$ withheld from paychecks
 - Annual tax return
- Tax on Income
 - Individuals
 - “Pass-through” business entities

Sales and Use Taxes

The Utah Sales and Use Tax Base: What Do We Tax?

Key transactions that are subject to tax include:

- Retail sales of tangible personal property
- Sales of certain telecommunication services or utility services (**reduced rate may apply**)
- Sales of food (**reduced rate may apply**)
- Certain admissions, such as movie tickets
- Certain services, such as a car wash when the purchaser doesn't perform the labor, repairs of tangible personal property, or dry cleaning
- Certain hotel or motel charges
- Products such as computer software transferred electronically
- "Use tax"

The Utah Sales and Use Tax: What Don't We Tax?

- Some transactions are not specifically exempt from sales and use taxes but are not part of the tax base, such as professional services or personal care services
- Other transactions are specifically exempt from sales and use taxes
 - Currently 69 exemptions
 - Estimated approximate state revenue effect for all exemptions for fiscal year 2008: \$700 Million

The Utah Sales and Use Tax Base: What Don't We Tax?

Some examples of major sales and use tax exemptions include:

<u>Exemption</u>	<u>FY 2009 State Impacts</u>
Motor and special fuels	\$109 M
Manufacturing machinery & equipment	\$105 M
Resale property / component parts	\$ 55 M
Prescription drugs	\$ 40 M
Certain religious / charitable sales & purchases	\$ 11 M
Farm machinery & equipment	\$ 10 M

State and Local Option Sales and Use Tax Rates

State tax rate +
Sum of local tax rates where transaction occurs
Tax rate imposed on a transaction

- The state tax rate depends on what is being taxed

For example:

General state tax rate	4.70%
Residential fuels tax rate	2.00%
Food and food ingredients tax rate	1.75%

Local Option Sales and Use Tax Rates

- Counties, cities, and towns are allowed to impose a variety of local sales and use taxes
- Most local option sales and use taxes tax the same transactions taxed at the state level
- Some local option sales and use taxes may be used for general fund purposes

For example:

Local sales and use tax	1.00%
County option sales and use tax	0.25%

Local Option Sales and Use Tax Rates

- Other local option sales and use taxes may only be used for purposes specified in statute

For example:

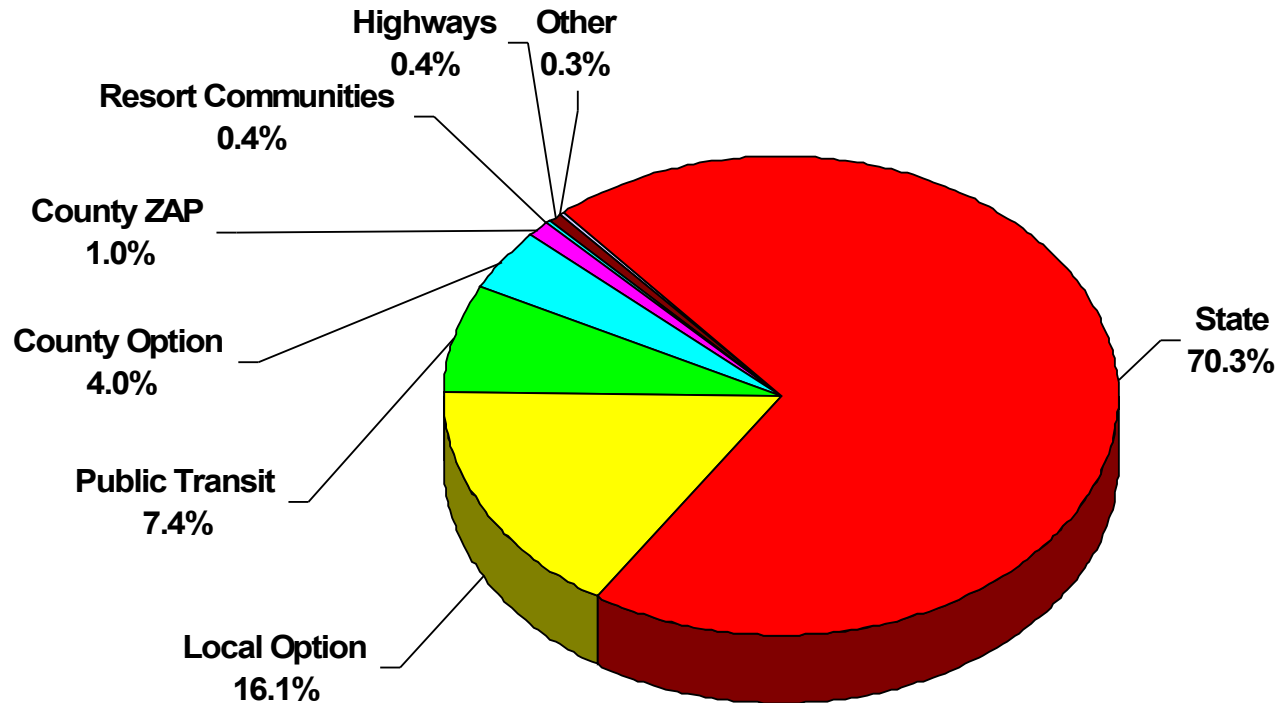
Public transit tax (funds public transportation systems)	up to 0.30%
County “ZAP” tax (“zoo, arts, and parks tax”)	0.10%

- Some local option sales and use taxes are imposed only on certain transactions, such as vehicle rentals, hotel or motel charges, or prepared food

For example:

County transient room tax on accommodations	up to 4.25%
County tax on food sold by restaurants (“TRCC tax”)	up to 1.00%

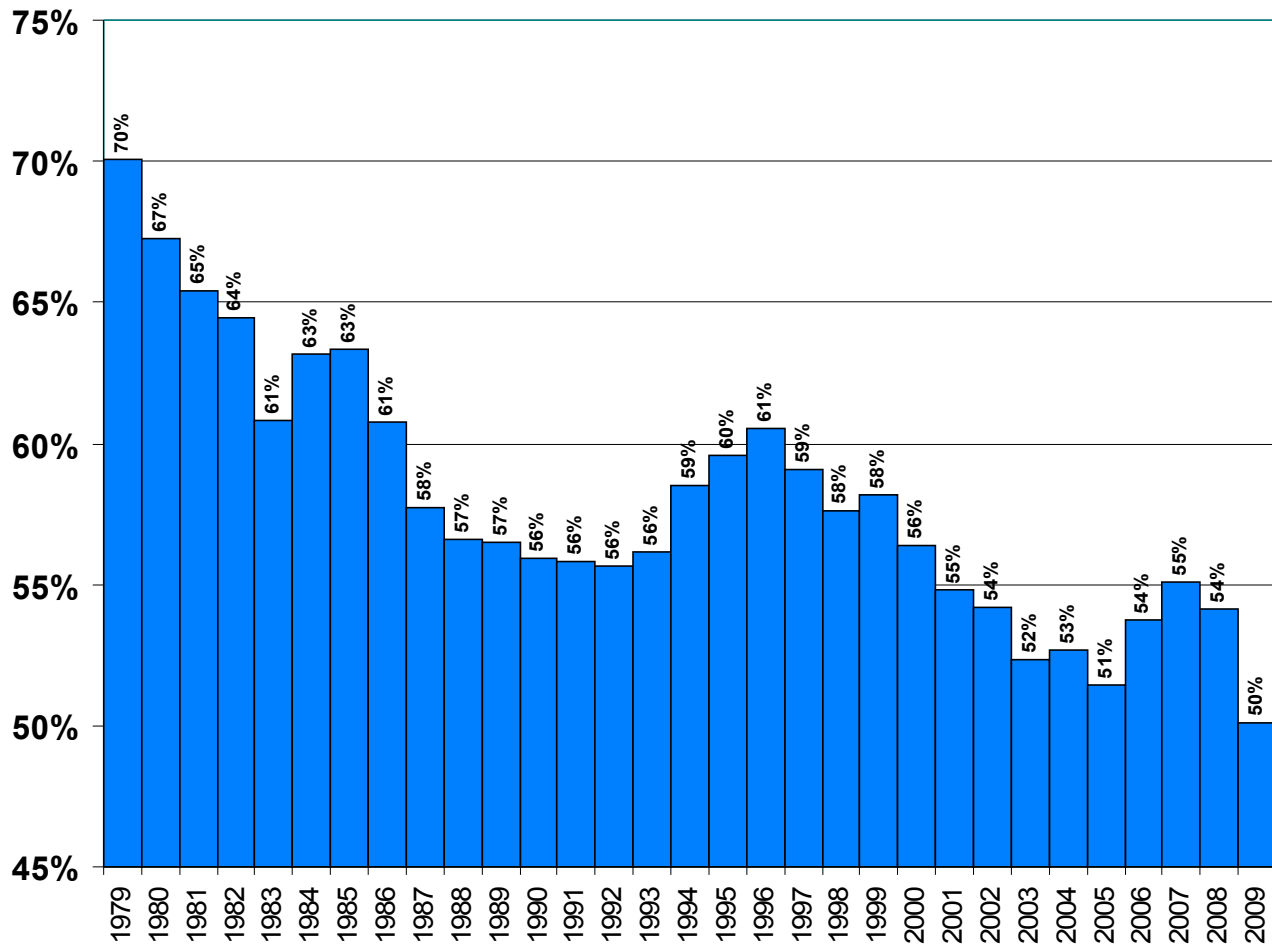
The Sales and Use Tax - Where Does the Money Go? FY 2009



Total State and Local Sales and Use Tax Revenue: \$2.643 billion

Sales Tax Base

Gross Taxable Sales as a % of Personal Income



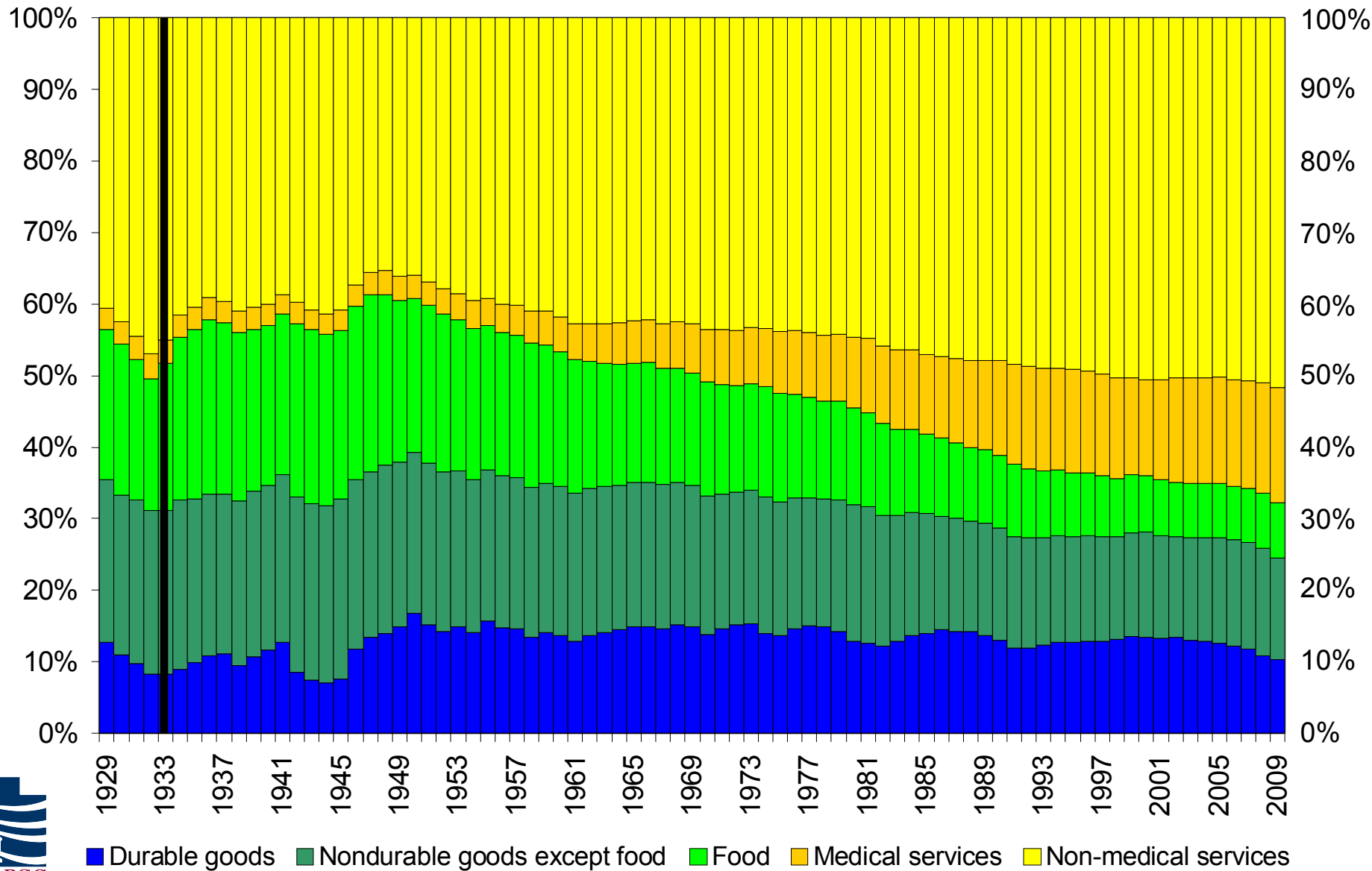
- Over the long term, the sales tax base is gradually declining relative to the economy as a whole.
- Why?

The Sales Tax Base:

Why is It Declining Over the Long Term?

- Changing purchasing patterns
 - Movement to more of a service-based economy
 - Many services excluded from sales tax base
- Cross-border shopping
 - Internet and catalogue purchases
- Technological change
 - Digitization of goods (software, books, music)
- Legislated exemptions

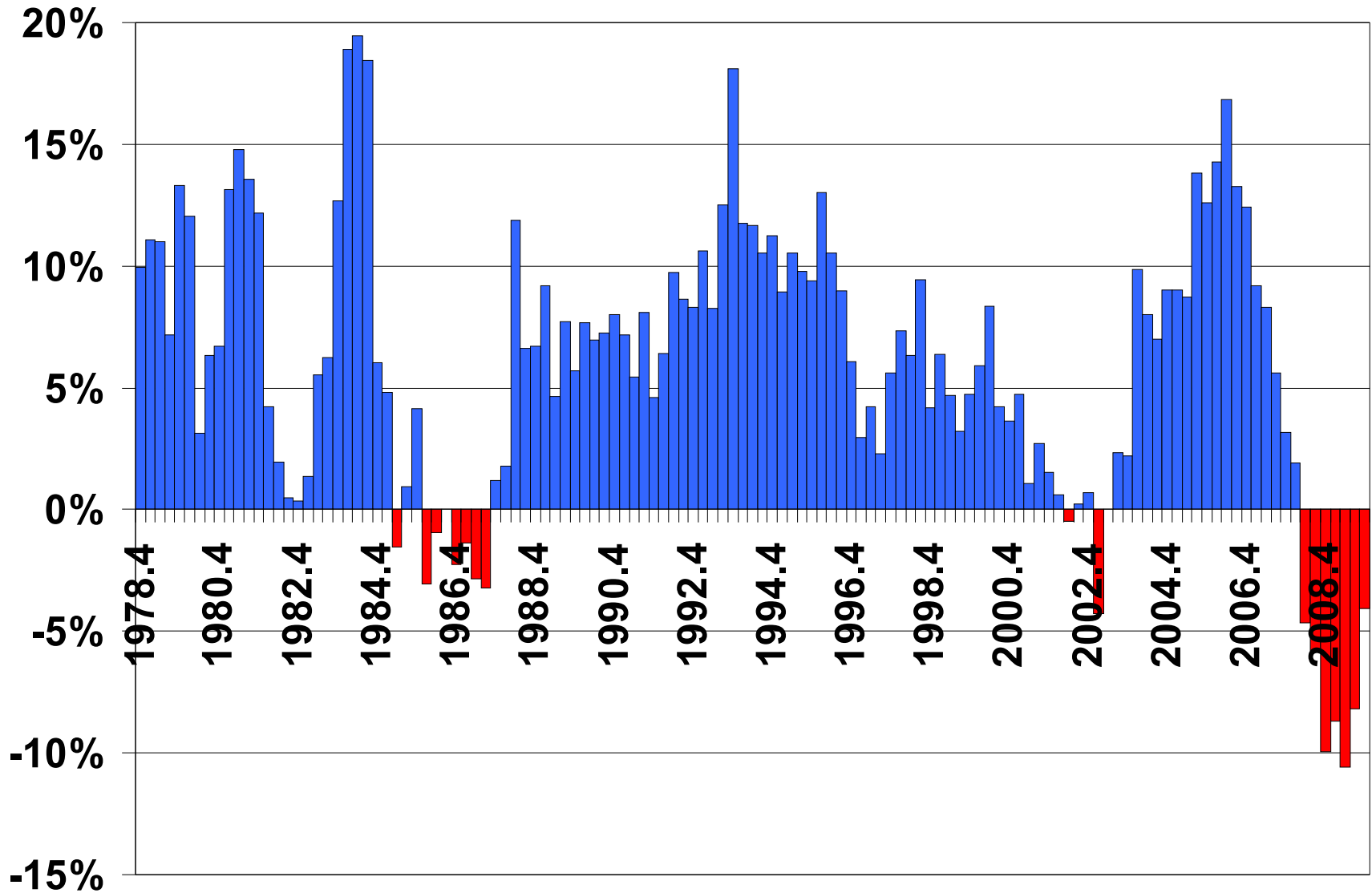
US Personal Consumption Expenditures



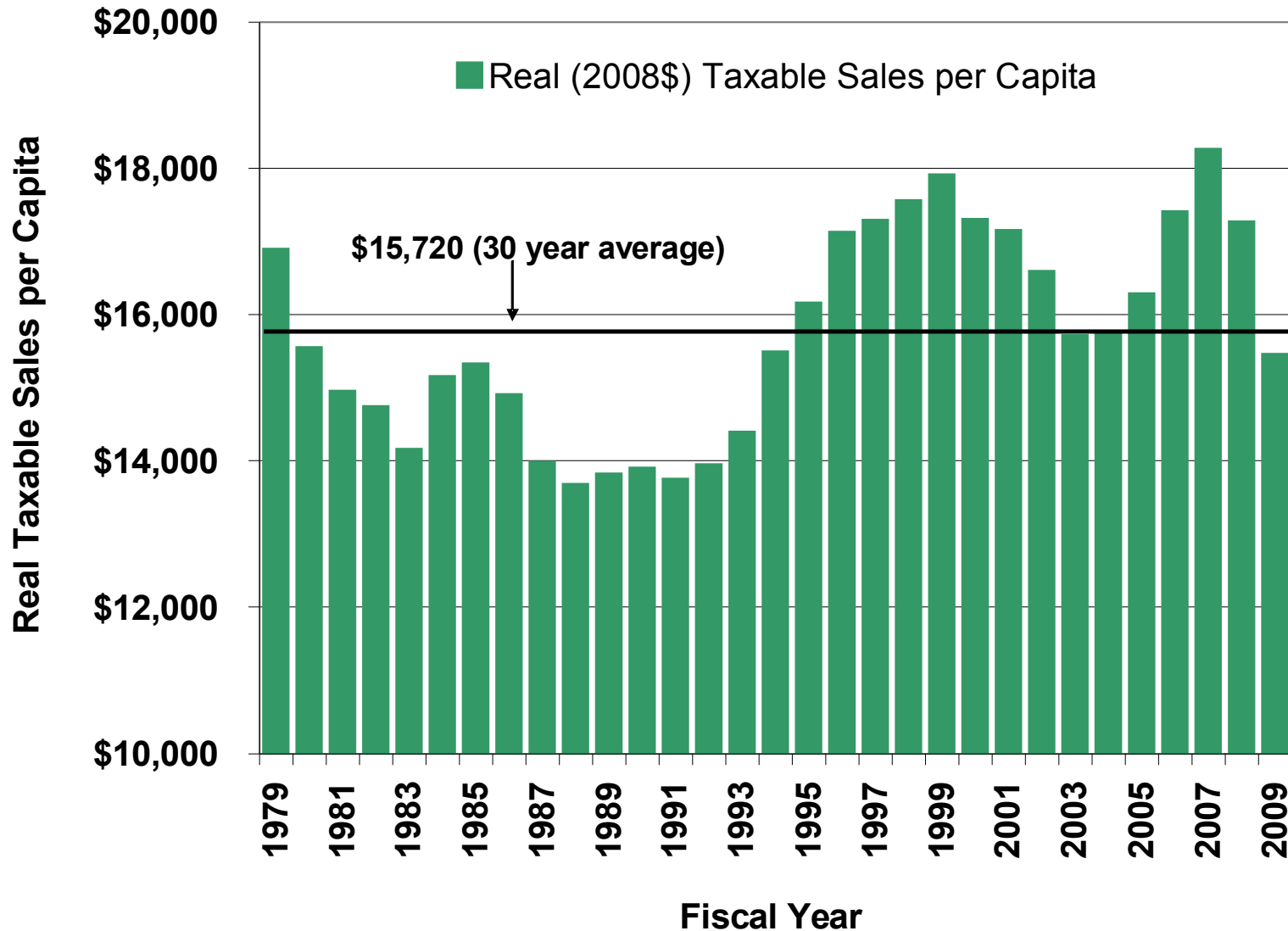
Data source: US Dept of Commerce, Bureau of Economic Analysis

Sales Tax Base

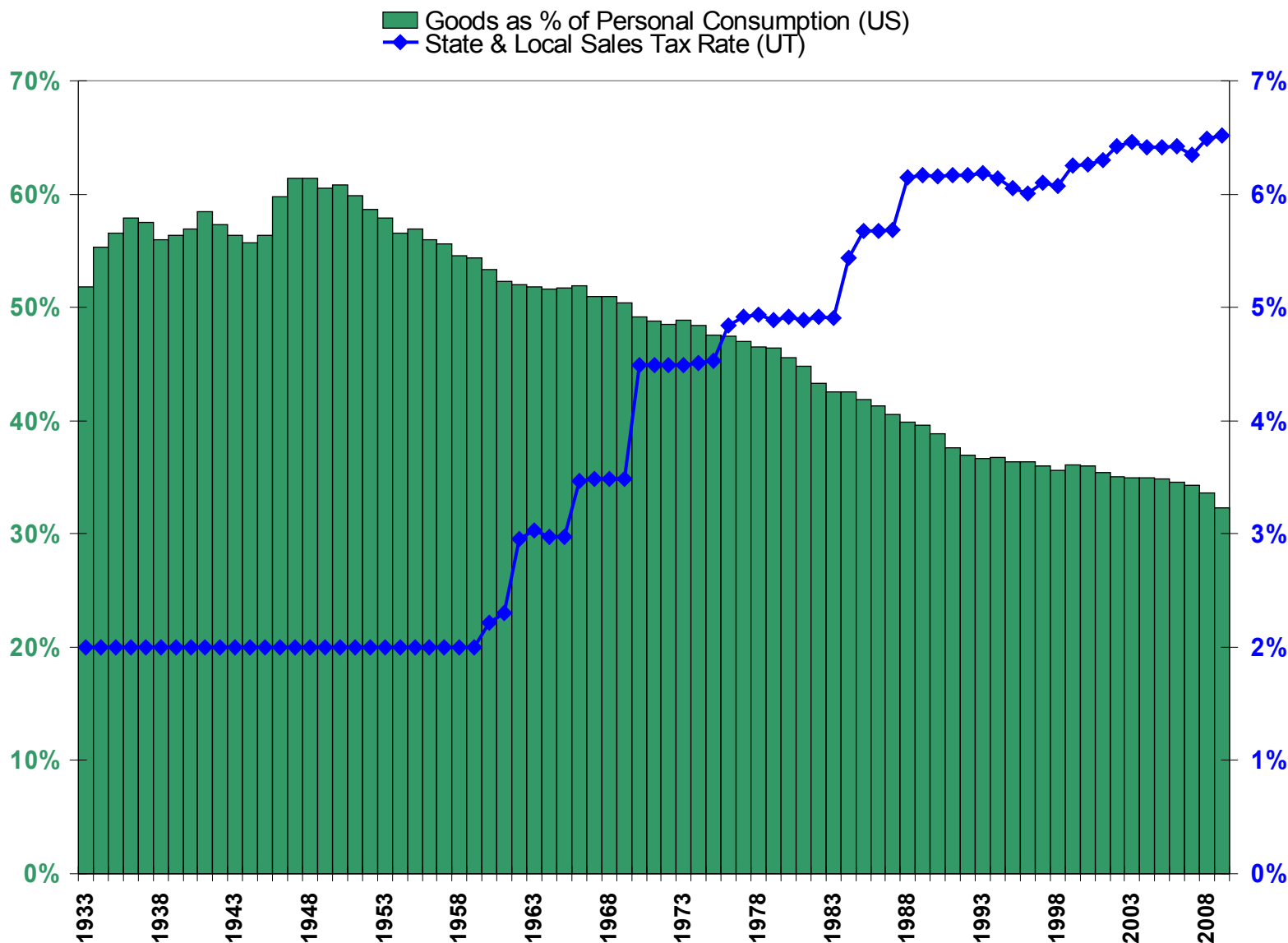
Nominal Gross Taxable Sales Changes



Inflation-Adjusted Per Capita Gross Taxable Sales

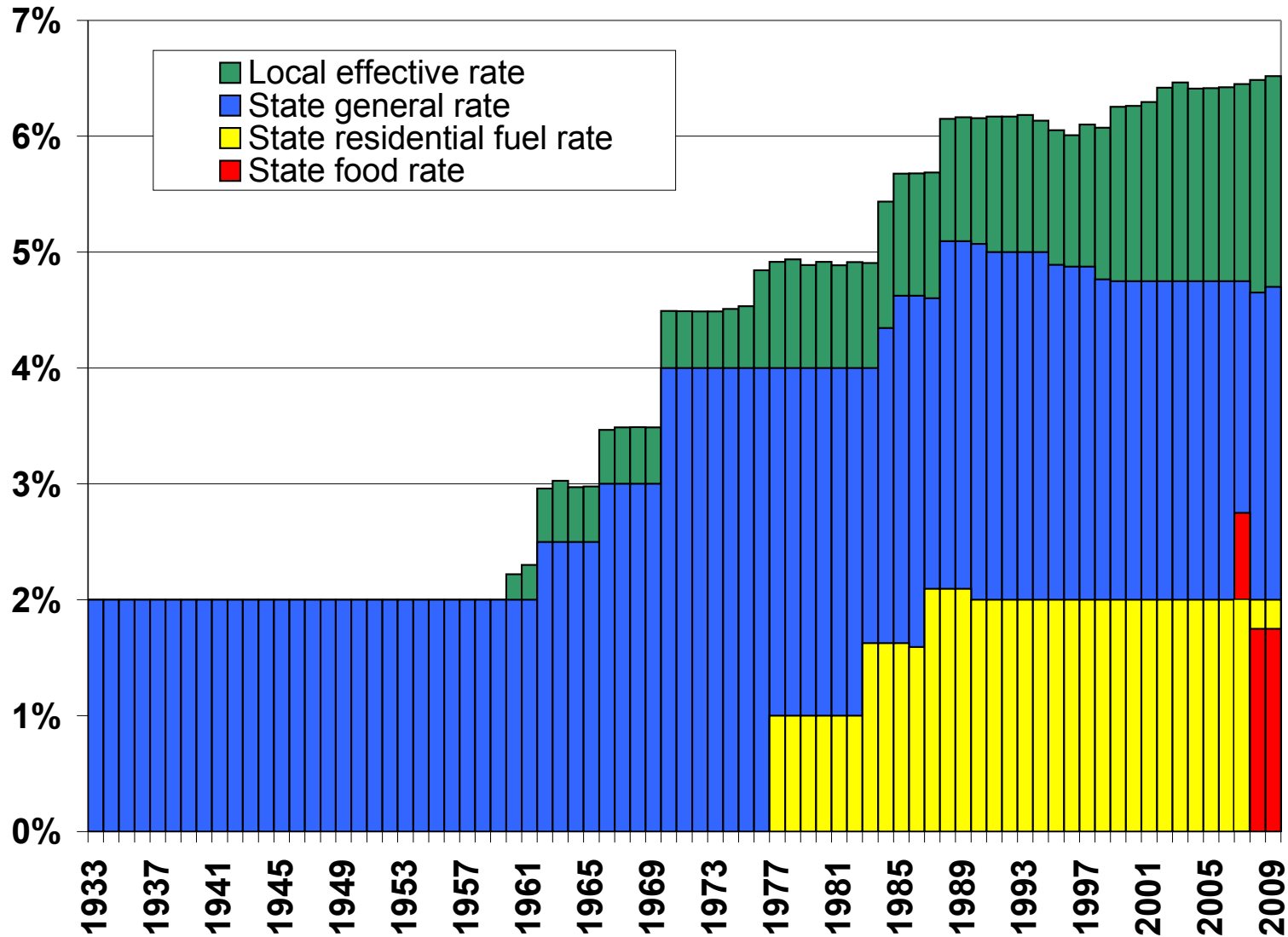


Shrinking Base, Increasing Rate



Data source: US Dept of Commerce, Bureau of Economic Analysis, Utah State Tax Commission

State & Local Sales Tax Rates



Why Does the Sales and Use Tax Matter?

- Most significant source of revenue to state government and state higher education system
- Significant source of revenue to local governments, Utah Transit Authority, and other public transit districts
- Taxes consumption
- Politically popular
- May be “exported”
- Impacts zoning decisions

Major Sales and Use Tax Issues

- Creation of new exemptions
- Taxes on food
- Local option sales and use taxes
- Compliance with Streamlined Sales and Use Tax Agreement
- Transportation funding
- Taxation of services
- State sales and use tax earmarking

The Property Tax

The Property Tax: Embedded in the Utah Constitution

- All tangible personal property, not exempt under the laws of the United States or this Constitution shall be:
 - Assessed at a uniform and equal rate in proportion to its fair market value; and
 - Taxed at a uniform and equal rate
- Land used for agricultural use may be assessed based on its value for agricultural purposes
- Intangible property:
 - Limit on tax rate; and
 - Prohibition on taxing income from intangible property if the property is taxed

Property Exempt from Taxation

- Property that SHALL be exempt from taxation includes:
 - Property owned by the state
 - Property owned by other governmental entities
 - Property owned by a nonprofit entity used exclusively for religious, charitable, or educational purposes
 - Farm equipment and farm machinery
 - Water rights, reservoirs, pumping plants, ditches, canals, pipes, flumes, power plants, and transmission lines owned and used by an individual to irrigate land

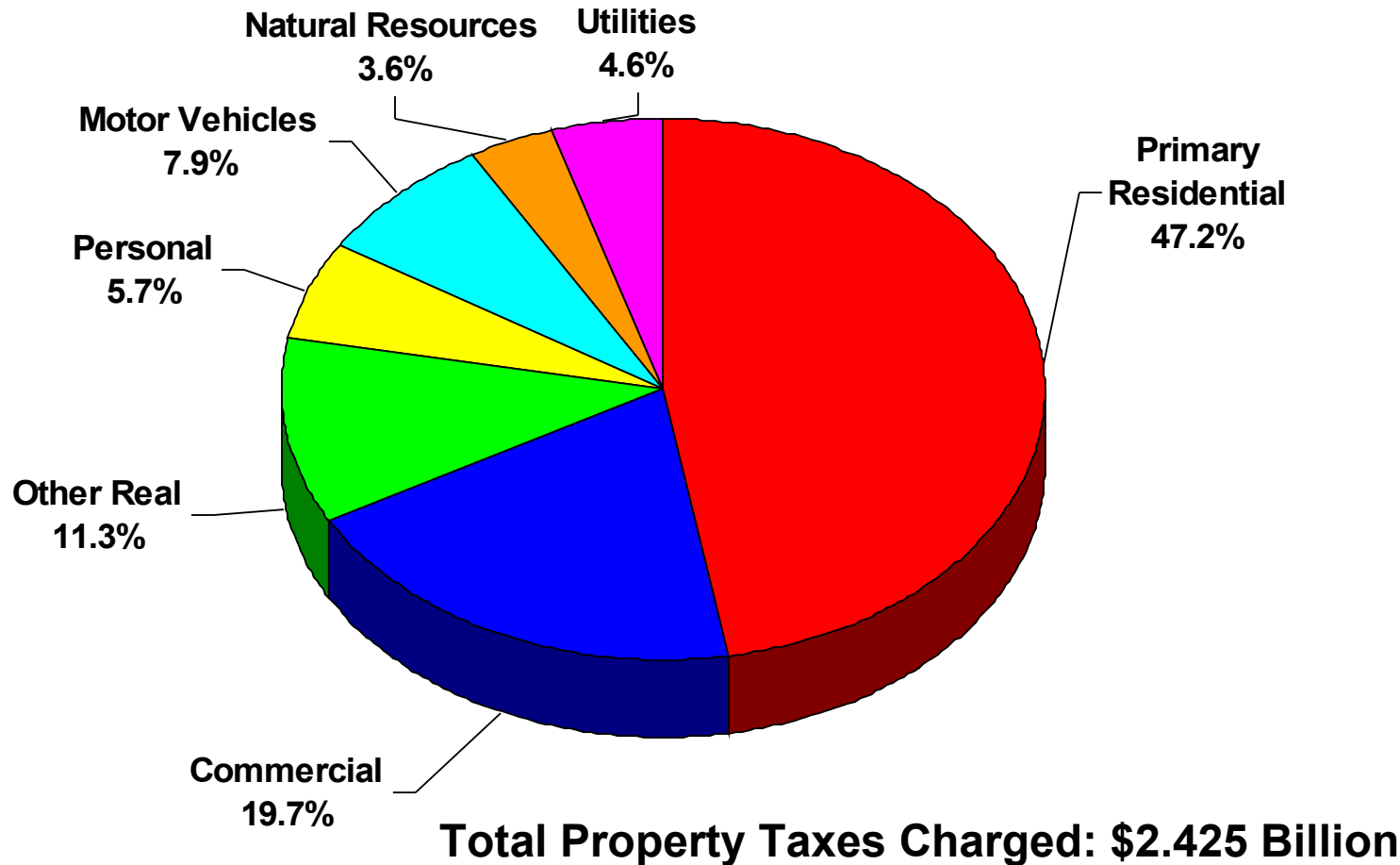
Property Exempt from Taxation

- Property that MAY be exempt from taxation includes:
 - Up to 45% of the fair market value of residential property
 - Household furnishings, furniture, and equipment used exclusively by the owner of property in maintaining the owner's home
 - Property owned by a veteran disabled in the line of duty
 - Personal property that, if taxed, would generate an inconsequential amount of revenue
- Taxes of the poor may be remitted or abated

Property Taxes

Where Does the Money Come From?

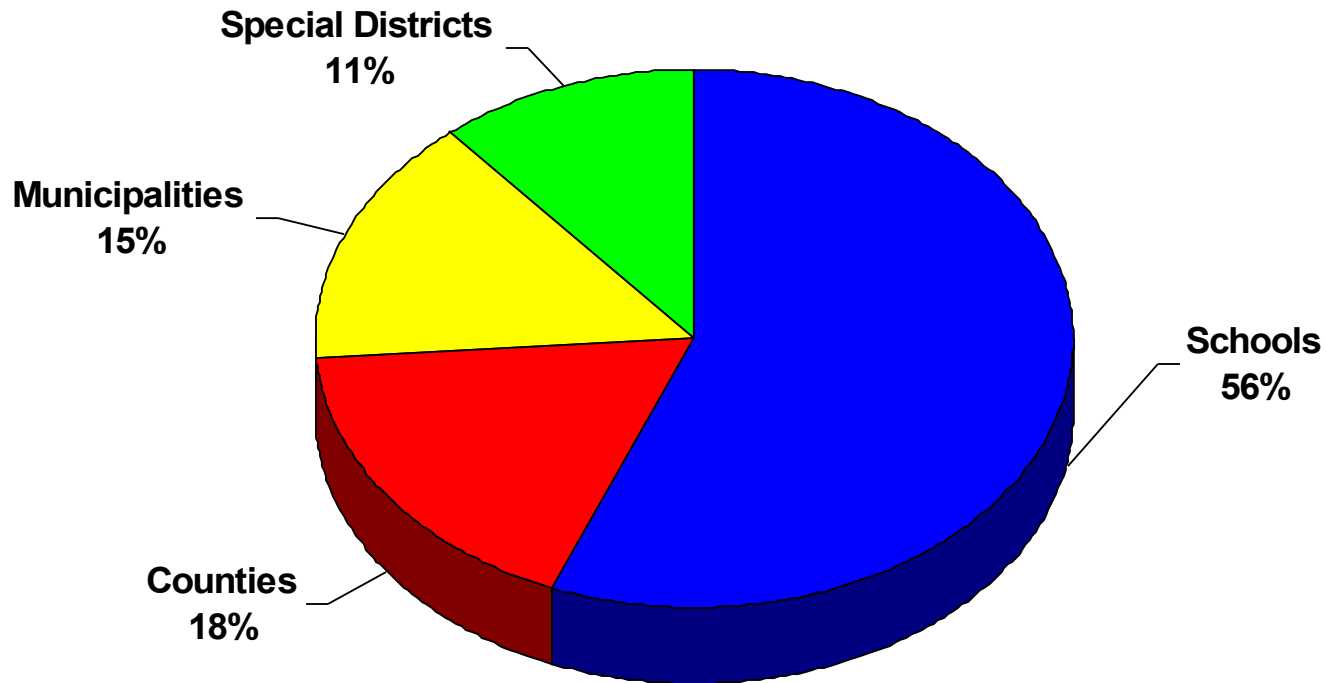
2008 Tax Year



Property Taxes

Where Does the Money Go?

2008 Tax Year



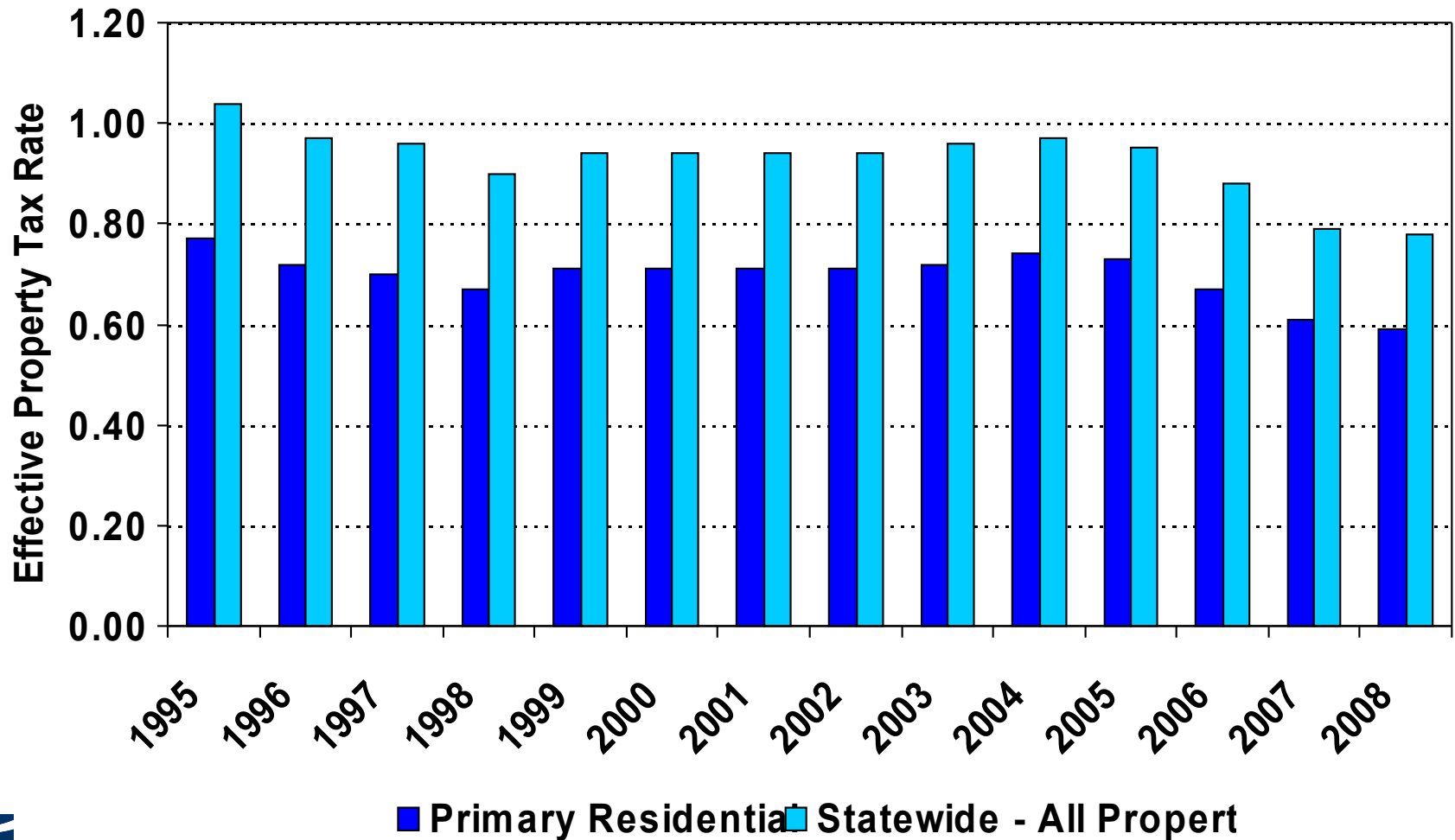
What has the Legislature done to keep property taxes as low as possible?

- 45% residential exemption
- Reductions in minimum basic school property tax levy
 - Never imposed a levy higher than the certified revenue levy
- Truth in Taxation
- Expanding options for local sales and use taxes
- Providing property tax relief to targeted groups

Effective Property Tax Rates

Primary Residential Property and All Property

1995 – 2008 Tax Years



Why Does the Property Tax Matter?

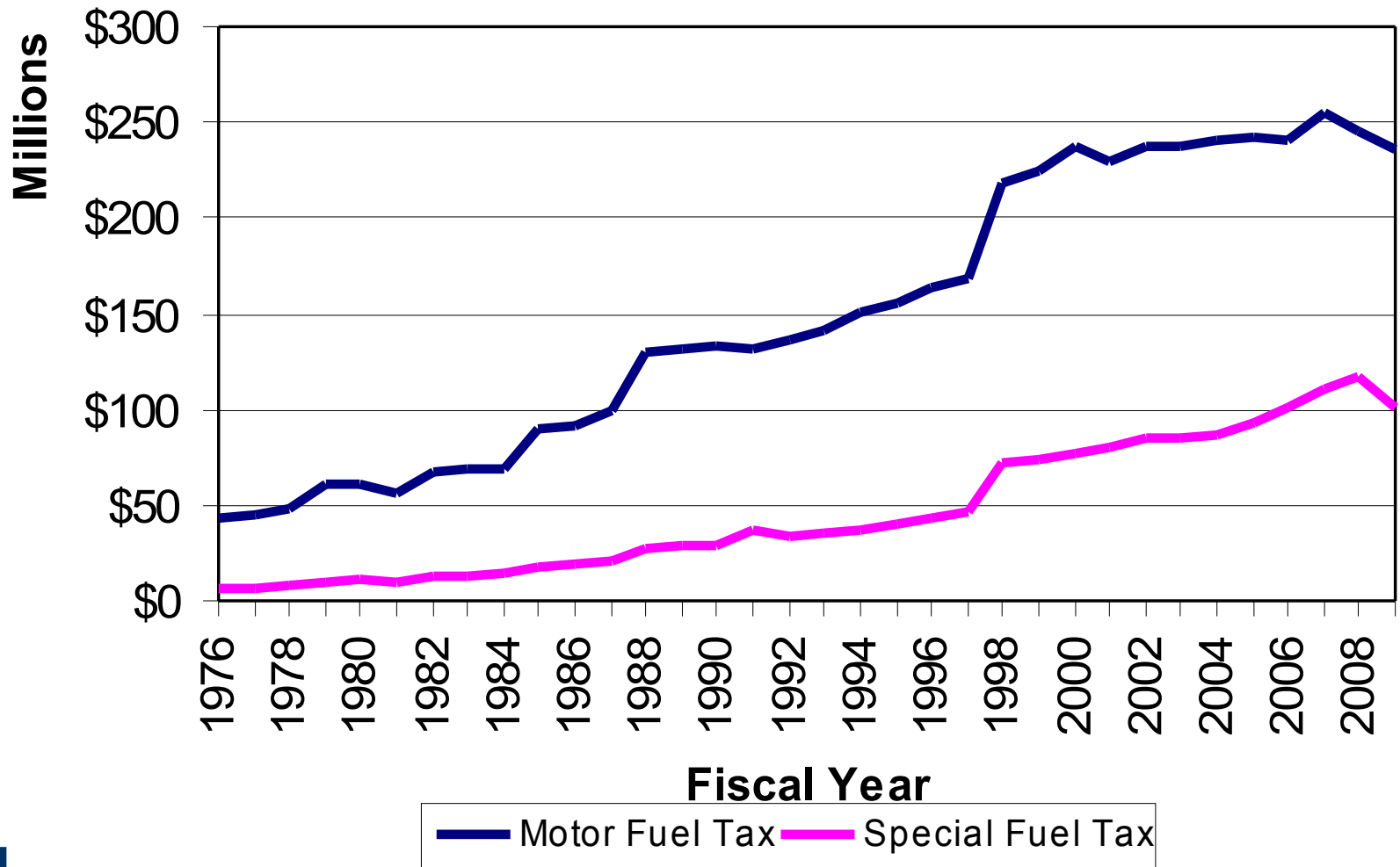
- Taxes wealth and capital
- Source of revenue for schools and other local government entities
- Oldest state and local tax
- Most stable and transparent
- Unpopular tax
- Provides political accountability

Major Property Tax Issues

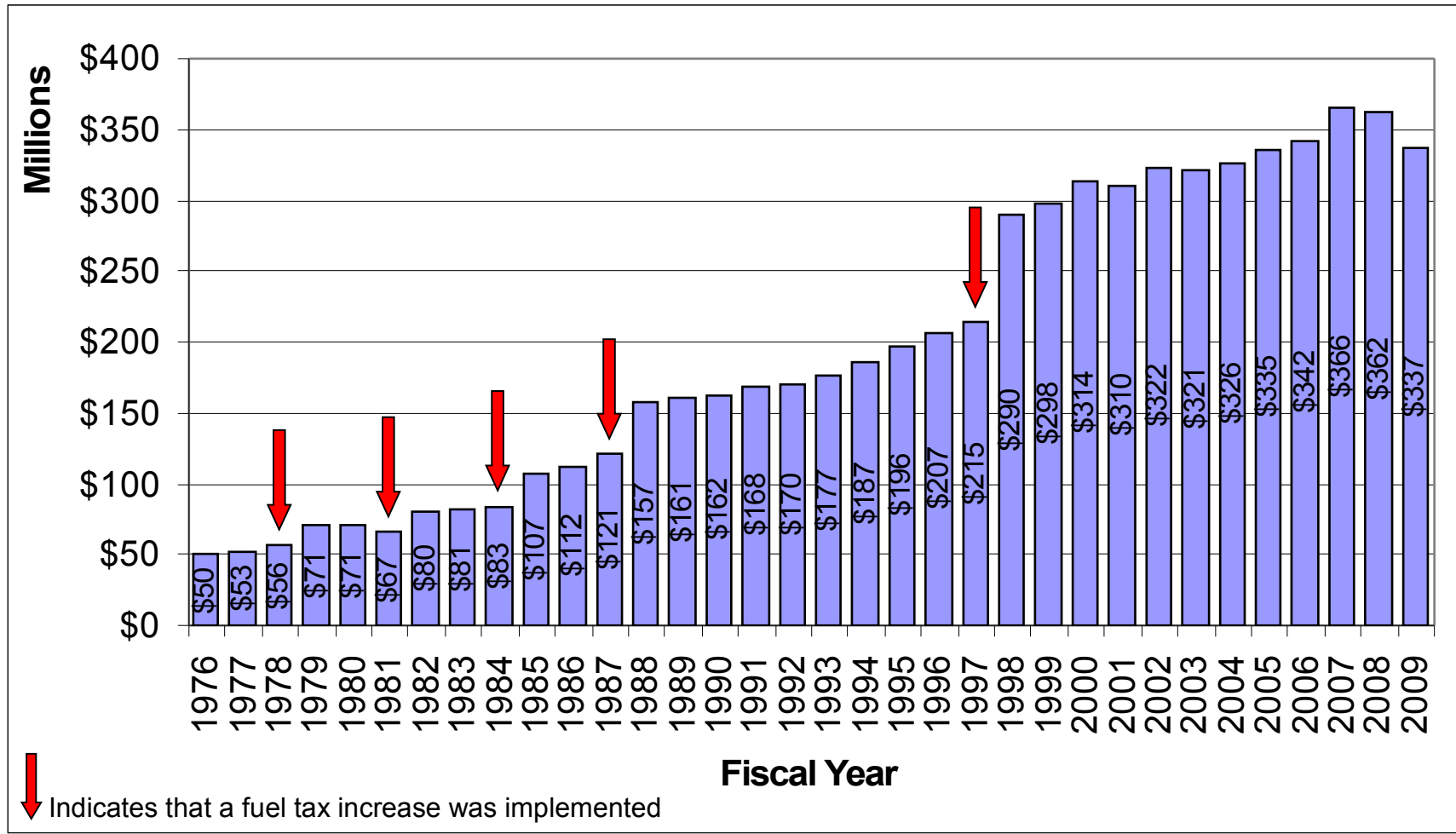
- Property value assessment practices of county assessors
- Improving taxpayer predictability
- Fair market valuation of property for purposes of taxation
- Acquisition cost as value of property for purposes of taxation
- Property tax relief
- Equalization of public school funding from property tax revenue

Motor and Special Fuel Taxes

Motor and Special Fuel Taxes Revenue



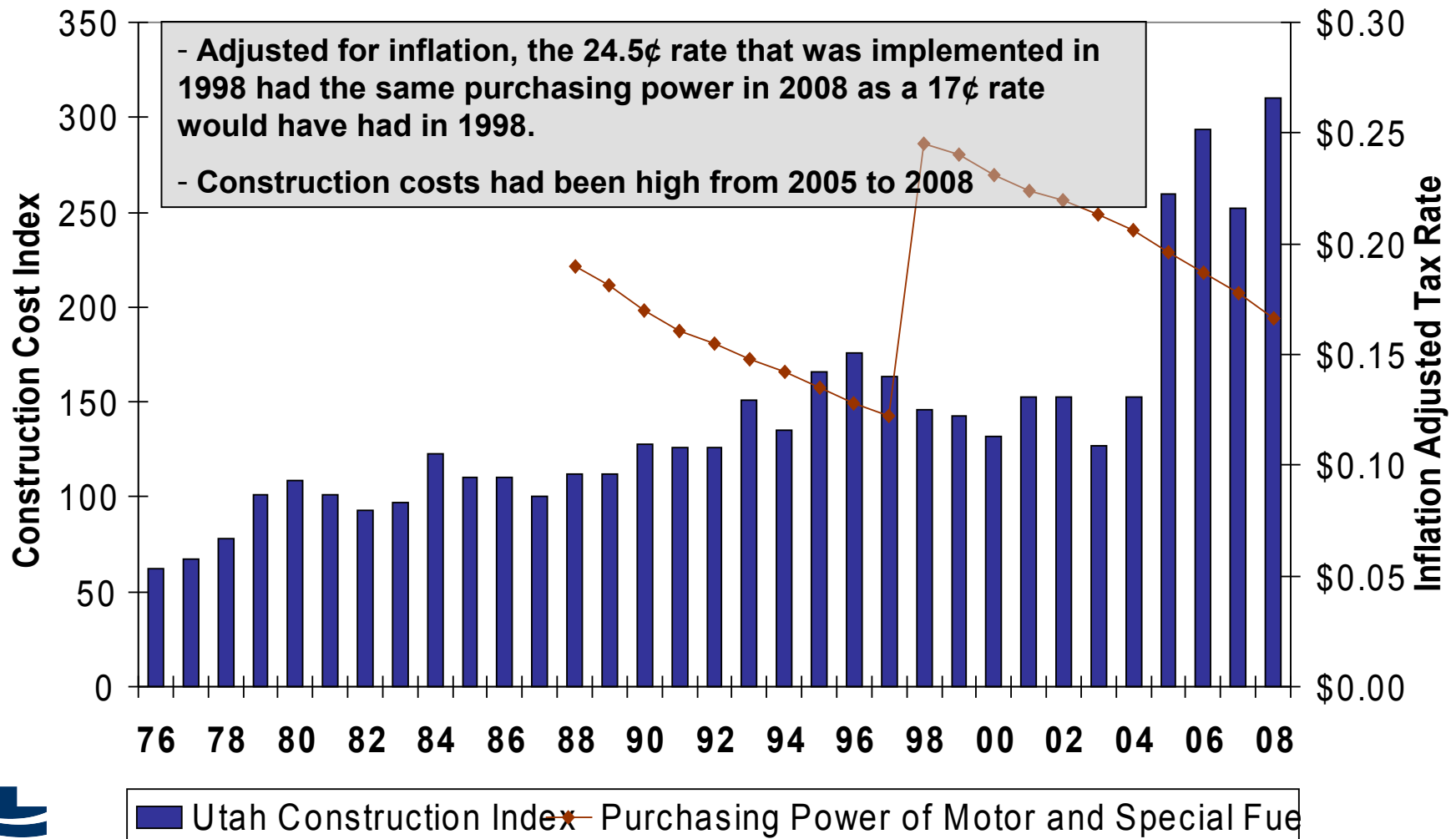
Combined Motor and Special Fuel Taxes Revenue



Where Does the Money Go?

- Revenues are constitutionally earmarked for highway purposes such as construction and maintenance
- Exception: collection and administration, driver education, and enforcement of motor vehicle and traffic laws

Why Does the Purchasing Power of Motor and Special Fuel Taxes Continue to Decline?



Why Do Motor and Special Fuel Taxes Matter?

- Most significant source of revenue to maintain state highway system
- User fee - tax on users of public highway system
- Politically unpopular

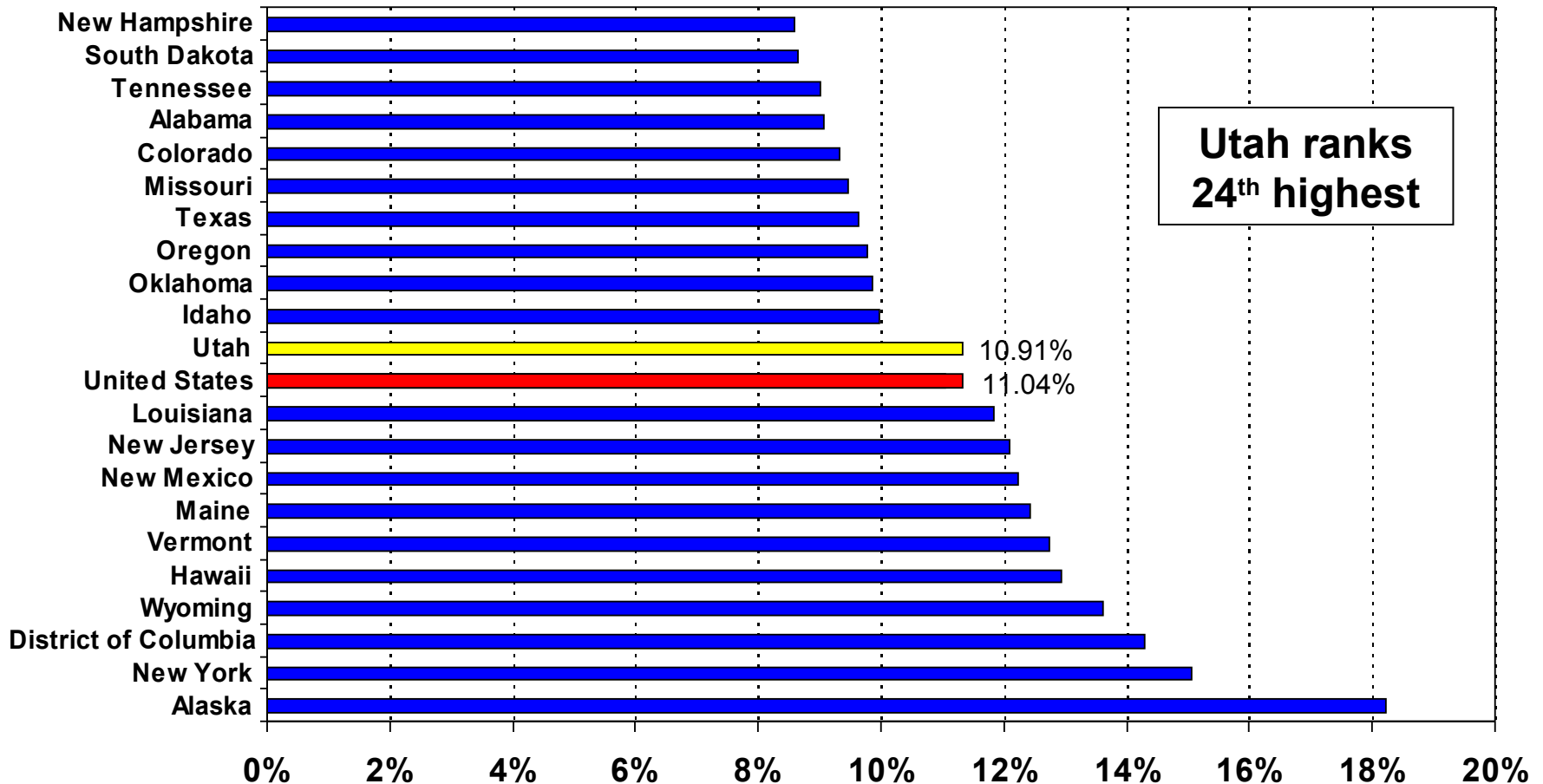
Major Motor and Special Fuel Taxes Issues

- Declining purchasing power
 - Inflation
 - Cost of construction materials
- Sufficiency
- Some motor vehicle fuels are difficult to tax
 - These fuels are becoming more prevalent
- Fuel Economy

Utah's State and Local Tax Burden: How Does It Compare to Other States?

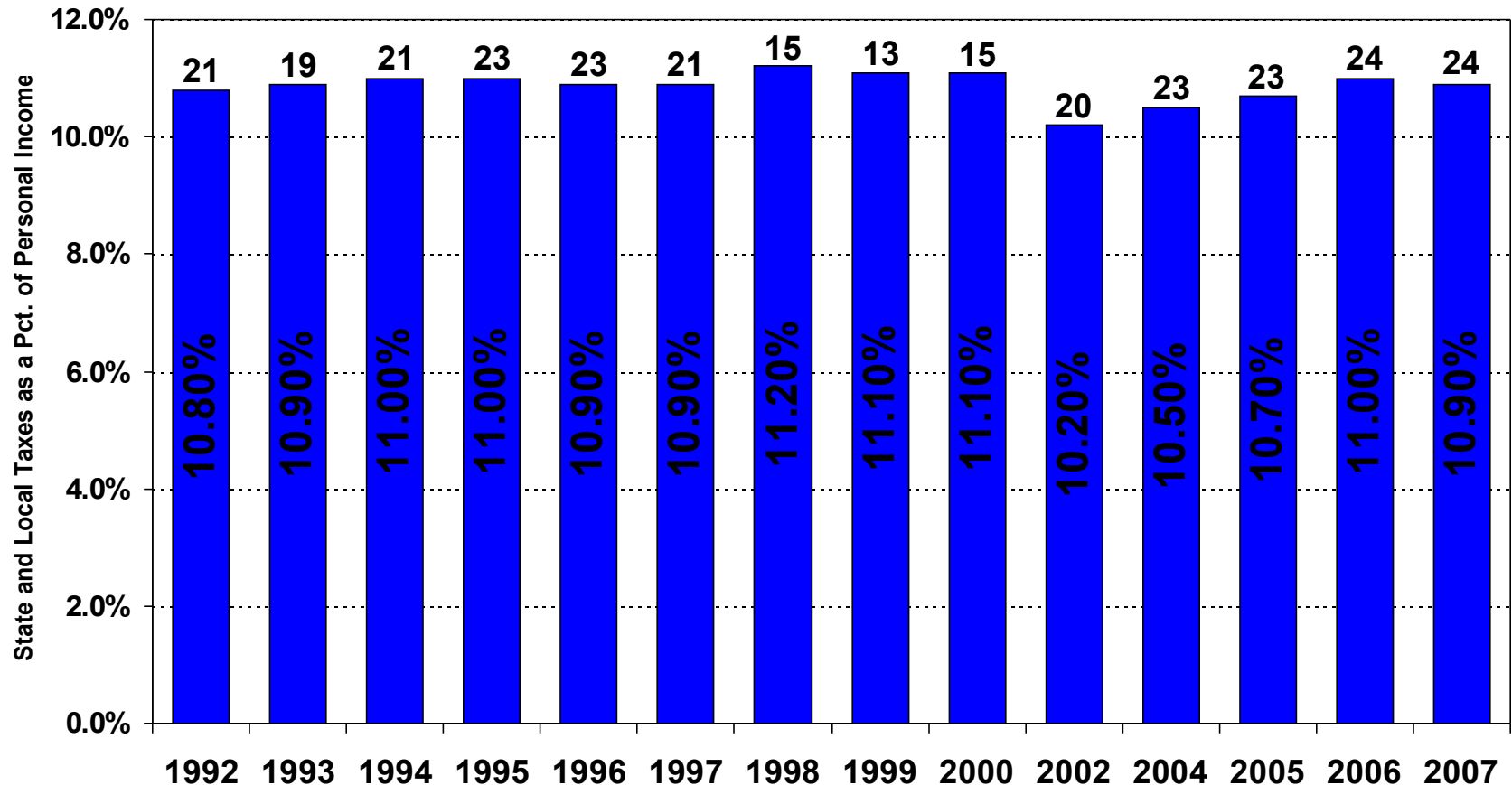
State and Local *Taxes* as a Percent of Personal Income

Ten Highest and Ten Lowest States, Utah, and the United States: FY 2006 - 2007



State and Local *Taxes* as a Percent of Personal Income

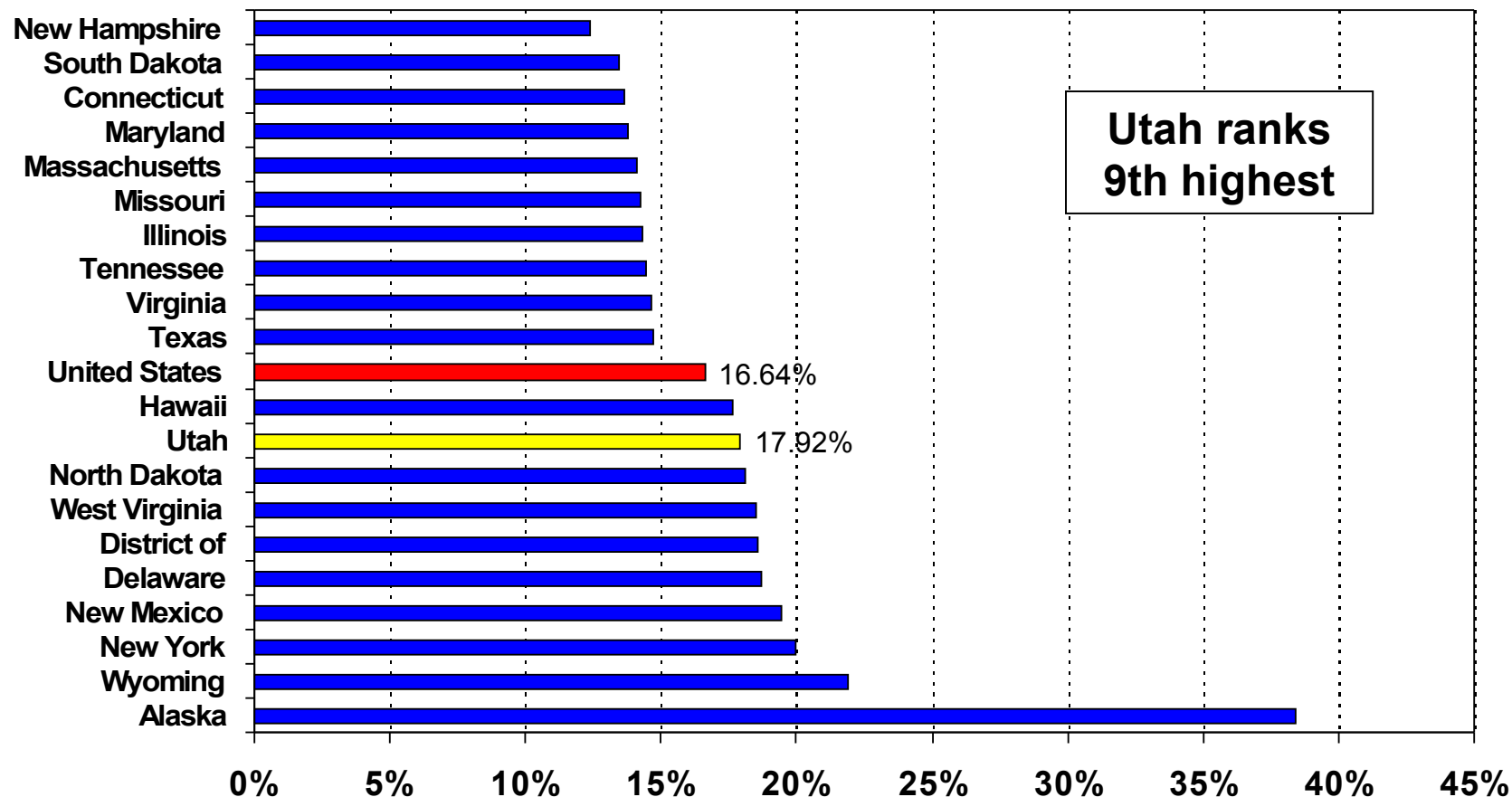
Utah: FY 1992 to FY 2007



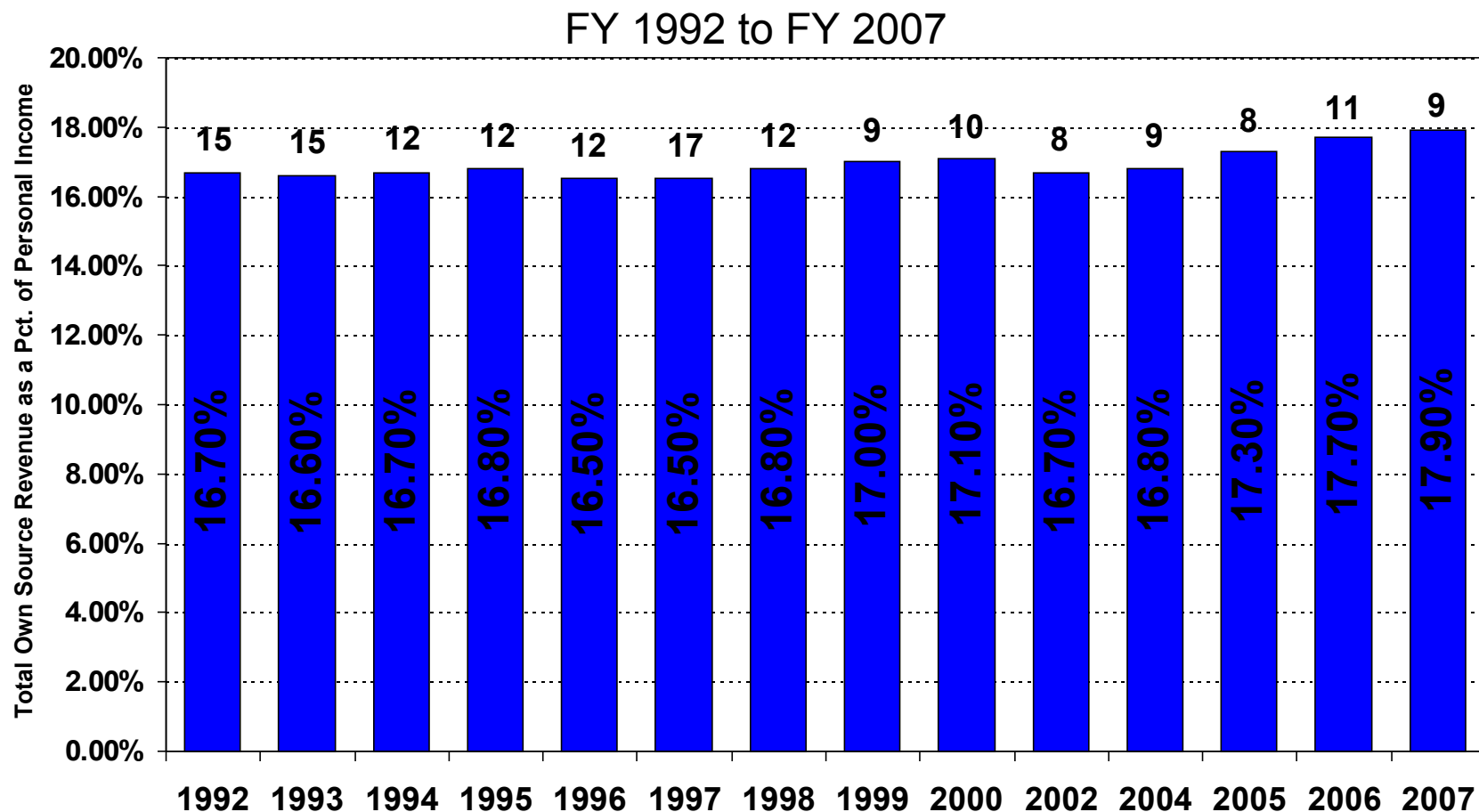
Number above each bar is Utah's rank out of all states and the District of Columbia.

State and Local *Total Own Source Revenue* as a Percent of Personal Income

Utah and the United States: FY 2006 - 2007



State and Local *Total Own Source Revenue* as a Percent of Personal Income



Number above each bar is Utah's rank out of all states and the District of Columbia.

Why Does Comparative State and Local Tax Burden Matter?

- State and local taxes are one factor (among many) in business investment and location decisions
 - The extent to which taxes matter is up for debate
- Important to know what other states are doing when making decisions about taxes and fees
- There are many ways to compare a state's tax and fee burden